No. 06-219
Title: Charles Wilkie, et al., Petitioners
v.
Harvey Frank Robbins
Docketed: August 11, 2006
Lower Ct: United States Court of Appeals for the Tenth Circuit
Case Nos.: (04-8016)
Decision Date: January 10, 2006
Rehearing Denied: March 14, 2006
Questions Presented

~~Date~~	~~~~~~~Proceedings and Orders~~~~~~~~~~~~~~~~~~~~~~
Jun 2 2006	Application (05A1118) to extend the time to file a petition for a writ of certiorari from June 12, 2006 to July 12, 2006, submitted to Justice Breyer.
Jun 5 2006	Application (05A1118) granted by Justice Breyer extending the time to file until July 12, 2006.
Jun 28 2006	Application (05A1118) to extend further the time to file a petition for a writ of certiorari from July 12, 2006 to August 11, 2006, submitted to Justice Breyer.
Jun 28 2006	Application (05A1118) granted by Justice Breyer extending the time to file until August 11, 2006.
Aug 11 2006	Petition for a writ of certiorari filed. (Response due September 11, 2006)
Sep 7 2006	Order extending time to file response to petition to and including October 11, 2006.
Oct 3 2006	Order further extending time to file response to petition to and including October 25, 2006.
Oct 25 2006	Brief of respondent Harvey Frank Robbins in opposition filed.
Nov 5 2006	Reply of petitioners Charles Wilkie, et al. filed. (Distributed)
Nov 7 2006	DISTRIBUTED for Conference of November 21, 2006.
Nov 27 2006	DISTRIBUTED for Conference of December 1, 2006.
Dec 1 2006	Petition GRANTED. The brief of petitioners is to be filed with the Clerk and served upon opposing counsel on or before 2 p.m., Friday, January 5, 2007. The brief of respondent is to be filed with the Clerk and served upon opposing counsel on or before 2 p.m., Friday, February 2, 2007. A reply brief, if any, is to be filed with the Clerk and served upon opposing counsel on or before 2 p.m., Friday, February 16, 2007.
Dec 22 2006	Extension of time within which to file the joint appendix and petitioners' brief on the merits to and including January 16, 2007.
Jan 10 2007	Extension of time within which to file respondent's brief on the merits to and including February 20, 2007.
Jan 16 2007	Joint appendix filed.
Jan 16 2007	Brief of petitioners Charles Wilkie, et al. filed.
Jan 16 2007	Brief amici curiae of National Wildlife Federation, et al. filed.
Jan 17 2007	SET FOR ARGUMENT ON Monday, March 19, 2007.
Feb 5 2007	Record received from U.S.C.A. for 10th Circuit. (1 box)
Feb 5 2007	CIRCULATED.
Feb 6 2007	Record received from U.S.D.C. for District of Wyoming. (2 boxes)
Feb 6 2007	Consent to the filing of amicus briefs in suport of either party received from counsel for

the respondents.

Feb 16 2007 Brief amicus curiae of Paragon Foundation, Inc. filed. (Distributed)

Feb 19 2007 Brief amici curiae of Pacific Legal Foundation, et al. filed. (Distributed)

Feb 19 2007 Brief amici curiae of Public Lands Council, et al. filed. (Distributed)

Feb 19 2007 Brief amicus curiae of Oregon Cattlemen's Association, et al. filed. (Distributed)

Feb 19 2007 Brief amici curiae of New Mexico Cattle Growers' Association, et al. filed. (Distributed)

Feb 20 2007 Brief of respondent Harvey Frank Robbins filed. (Distributed)

Feb 20 2007 Brief amici curiae of Brooks Realty and Burgett Geothermal Greenhouses, Inc. filed. (Distributed)

Feb 20 2007 Brief amicus curiae of Mountain States Legal Foundation filed.

Mar 12 2007 Reply of petitioners Charles Wilkie, et al. filed. (Distributed)

Mar 19 2007 ARGUED. For petitioners: Gregory G. Garre, Deputy Solicitor General, Department of Justice, Washington, D.C. For respondent: Laurence H. Tribe, Cambridge, Mass.

Supreme Court, U.S.
FILED
06-480 OCT 4 - 2006
OFFICE OF THE CLERK

No.

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

This Court has held that antitrust "*per se* rules are appropriate only for conduct that . . . would always or almost always tend to restrict competition." Modern economic analysis establishes that vertical minimum resale price maintenance does not meet this condition because the practice often has substantial competition-enhancing effects. The question presented is whether vertical minimum resale price maintenance agreements should be deemed *per se* illegal under Section 1 of the Sherman Act, or whether they should instead be evaluated under the rule of reason.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

In addition to the parties named in the caption, Toni Cochran L.L.C., doing business as Toni's, was a plaintiff below.

Pursuant to this Court's Rule 29.6, undersigned counsel state that Leegin Creative Leather Products, Inc. is a wholly owned division of Brighton Collectibles, Inc. No publicly held company owns 10% or more of its stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Leegin Creative Leather Products, Inc. ("Leegin") respectfully submits this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The court of appeals' opinion is unpublished but electronically reported at 2006 WL 690946. App., *infra*, at 1a. The order denying Leegin's petitions for rehearing and for rehearing en banc is unreported. *Id.* at 16a. The opinion of the United States District Court for the Eastern District of Texas is unreported. *Id.* at 12a.

JURISDICTION

The district court had jurisdiction over respondent's claims pursuant to 28 U.S.C. § 1331. The court of appeals had jurisdiction to review the district court's final judgment pursuant to 28 U.S.C. § 1291. The court of appeals filed its opinion on March 20, 2006. It denied Leegin's timely petitions for rehearing and for rehearing en banc on July 19, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 1 of the Sherman Act (15 U.S.C. § 1) provides, in pertinent part:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is hereby declared to be illegal.

STATEMENT

This case is an ideal vehicle for this Court to revisit its decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which relied upon the antiquated common-law rule against "restraints on alienation" to hold that a vertical agreement between a manufacturer and its retailers establishing minimum resale prices for the manufacturer's goods is a *per se* violation of the Sherman Act. *Id.* at 404. This *per se* rule—on which the Fifth Circuit relied in affirming the district court's judgment—squarely conflicts with accumulated economic knowledge, which recognizes that vertical minimum resale price maintenance can have significant *procompetitive* effects, and with this Court's modern antitrust jurisprudence, including decisions revisiting and rejecting analogous *per se* rules prohibiting other vertical agreements. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). As in *Khan* and *Sylvania*, the *per se* rule at issue here has been subject to overwhelming criticism and lacks support under the economic approach that this Court's recent antitrust jurisprudence has applied.

1. Leegin has built a successful family business in the crowded and intensely competitive marketplace for women's fashion accessories. In 1990, Leegin introduced the "Brighton" brand with a line of women's belts, and it later added other types of accessories to the Brighton line. Leegin has differentiated its products from the myriad other brands of leather goods and accessories available in department stores and mass merchandisers by focusing on boutique stores offering a level of service and personal attention that consumers often cannot find elsewhere. 6.R.5-11.[1]

Leegin's strategy has succeeded. Brighton has become a brand equated with quality, value, and customer service.

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[1] "R" refers to the record on appeal. Citations to the record are to the volume of the record, followed by the page number in that volume.

Brighton products did not even exist until 1990, yet ten years later, despite competition from hundreds of other brands of women's accessories, Brighton products were sold in more than 5,000 specialty stores nationwide. 5.R.125-26; 6.R.17-20; 7.R.15. While Leegin has achieved impressive success from its humble beginnings, it is still a small company when compared to the much larger manufacturers and department stores with which it and its retailers compete. 3.R.813-20.

2. In 1997, Leegin instituted the "Brighton Retail Pricing and Promotion Policy," pursuant to which Leegin announced that it would do business exclusively with retailers who follow its suggested retail prices for Brighton products. 6.R.10.[2] There were two principal reasons for Leegin's adoption of the pricing policy. First, it was Leegin's view that the typical retail strategy of putting products on and off "sale" degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment. 5.R.106-24. Leegin's policy instead furthered an "everyday fair price" approach. *Id.* Second, the pricing policy was designed to develop the Brighton brand by giving retailers incentives to provide special attention and service to Brighton customers. 5.R.115-27. In small specialty stores, attractive presentation and customer service are central to the shopping experience, but providing those services is not costless to retailers. *Id.* Through its pricing policy, Leegin ensured a sufficient margin to retailers to give them the incentive to focus on Brighton products and to provide high-quality service. *Id.*

Leegin's pricing policy was successful, and sales of Brighton products grew considerably after its inception. For example, sales of Brighton handbags increased from 125,609 units in 1996, to 375,480 units in 2003. *See* Expert Report of Kenneth G. Elzinga ("Elzinga Report") at 20 n.26 (App., *infra*, at 37a).

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[2] Leegin's pricing policy permitted retailers to discount products that they did not wish to re-order from Leegin.

3. Plaintiff PSKS, which operated a retail store known as "Kay's Kloset" in Lewisville, Texas, was one of the stores to which Leegin sold Brighton products. In December 2002, Leegin learned that PSKS was selling all Brighton products below the suggested prices, in violation of Leegin's pricing policy. 6.R.112-13. In response, Leegin suspended all shipments of Brighton products to PSKS. 6.R.118-19; 7.R.102-09. PSKS then filed this suit, alleging that Leegin's pricing policy constituted an unlawful agreement in restraint of trade.

The district court refused to allow Leegin to introduce evidence that its pricing policy promoted interbrand competition, and excluded the testimony of Leegin's economic expert, Professor Kenneth G. Elzinga. 1.R.325-33. Professor Elzinga would have testified, *inter alia*, that Leegin lacks market power and that its pricing practices are procompetitive because they foster interbrand competition. Elzinga Report at 5-20 (App., *infra*, at 22a-37a). The district court also denied Leegin's request for an instruction that would have allowed the jury to apply the rule of reason (1.R.190-92), which requires an antitrust plaintiff to demonstrate that the defendant's conduct unreasonably restrains competition in a relevant market before it will be found unlawful (*see Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006)), and instead instructed the jury that the alleged resale price maintenance agreement is *per se* unlawful (11.R.42).

The jury found that Leegin's policy constituted a resale price maintenance agreement, and based on the verdict, the court awarded PSKS $3.6 million in damages and $375,000 in attorneys' fees. App., *infra*, at 3a. Leegin renewed its motion for judgment as a matter of law and moved in the alternative for a new trial. The court denied Leegin's motions, stating that "[w]hether the per se classification of such agreements is wise is not for this court to decide." *Id.* at 12a.

The Fifth Circuit affirmed the district court's decision, rejecting Leegin's request for rule-of-reason treatment because lower courts "remain bound by [the Supreme Court's]

holding in *Dr. Miles*." App., *infra*, at 4a. The Fifth Circuit called for a response to Leegin's petitions for rehearing and for rehearing en banc, but eventually denied the petitions.

After the Fifth Circuit refused to stay its mandate, Leegin applied to Justice Scalia for a stay pending the filing and disposition of a petition for a writ of certiorari. No. 06A179. Justice Scalia granted a temporary stay pending a response from PSKS. After a response was received, Justice Scalia referred the application to the Court, which granted the stay pending the filing and disposition of this petition.

REASONS FOR GRANTING THE PETITION

The *per se* rule against resale price maintenance squarely conflicts with this Court's modern antitrust jurisprudence, which has rejected *per se* treatment of analogous vertical agreements because such treatment lacked an economic justification. *See Sylvania*, 433 U.S. at 47-48 (rejecting the *per se* rule against vertical nonprice restraints, and explaining that the "great weight of scholarly opinion ha[d] been critical of the" rule); *Khan*, 522 U.S. at 18 (unanimously overturning the *per se* rule against vertical maximum price-fixing because there was "insufficient economic justification" for the rule); *see also Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 126 S. Ct. 1281, 1290-91 (2006) (unanimously overturning the presumption of *per se* illegality of a tying arrangement involving a patented product because it was inconsistent with economic analysis). Like the *per se* rules rejected in *Sylvania*, *Khan*, and *Independent Ink*, the rule of *Dr. Miles* has no foundation in economic theory because it is well-established that vertical minimum resale price maintenance agreements often have substantial procompetitive effects. The validity of such agreements is therefore more appropriately determined under the rule of reason, rather than through application of a rigid *per se* rule.

This Court "presumptively applies rule of reason analysis" to antitrust claims. *Dagher*, 126 S. Ct. at 1279. The Court has emphasized that a "departure from the rule-of-reason standard must be based upon demonstrable economic

effect." *Sylvania*, 433 U.S. at 58-59. The *per se* prohibition on resale price maintenance, however, rests upon outdated common-law notions that are inconsistent with economic theory and that were expressly rejected by this Court in *Sylvania* and *Khan*. Not surprisingly, legal and economic commentators have leveled sharp criticism at this *per se* rule, pointing out that it lacks any economic justification. For example, Judge Posner has described the *per se* rule against resale price maintenance as "a sad mistake," explaining that "[t]here is neither theoretical basis, nor empirical support, for thinking the practice generally anticompetitive." Richard A. Posner, *Antitrust Law* 189 (2d ed. 2001) [hereinafter Posner, *Antitrust Law*]. Numerous other commentators are in accord. *See, e.g.*, Thomas R. Overstreet, Jr., Bureau of Econ., Fed. Trade Comm'n, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 164 (1983) ("the economic theories and the available empirical evidence rather clearly suggest that the rigid application of a strict standard of *per se* illegality for RPM [resale price maintenance] is inappropriate").

Moreover, because of its overbreadth, the rule of *Dr. Miles* inflicts substantial harm on competitive market processes. In particular, the rule proscribes conduct that, if permitted, would frequently be used for procompetitive purposes and would enhance consumer welfare. In this case, for example, Leegin is a small competitor that used resale price maintenance to provide incentives for retailers to market its products effectively against its larger rivals. The antitrust laws should promote, not condemn, a small manufacturer's efforts to expand its output through aggressive interbrand competition. The *per se* rule against resale price maintenance, however, undercuts this competitive tool and thus undermines interbrand competition—a result that is antithetical to the objectives of the antitrust laws.

This case, which is final in all respects, presents a singularly appropriate vehicle to reconsider the *per se* rule against resale price maintenance, which the Court has not squarely addressed under its modern antitrust jurisprudence. Review

by this Court is necessary to overturn this far-reaching and anachronistic *per se* rule and to bring the law of resale price maintenance into step with the law governing other vertical restraints.

I. THE RULE OF *DR. MILES* IS INCONSISTENT WITH THIS COURT'S MODERN ANTITRUST JURISPRUDENCE.

The *per se* rule against resale price maintenance is the lone remaining vestige of an antiquated antitrust regime that cannot be reconciled with either recent antitrust decisions or economic theory. This Court has abandoned the *per se* rules against other vertical arrangements—including vertical maximum price-fixing arrangements and all types of vertical nonprice restraints. Each of those other *per se* rules—like the rule of *Dr. Miles*—was based on the "ancient rule against restraints on alienation" (*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 380 (1967)), which has no grounding in economics. And each of the other vertical *per se* rules was rejected when the Court applied an approach to antitrust analysis grounded in real-world economics. This Court should reexamine the rule of *Dr. Miles* to resolve the conflict between that outdated and overbroad *per se* rule and the Court's antitrust decisions of the last thirty years.

A. This Court Has Overturned Analogous *Per Se* Rules Against Other Vertical Agreements.

1. Nearly a century ago, this Court in *Dr. Miles* invalidated an agreement that required a manufacturer's dealers to abide by a minimum resale price. Without considering the competitive consequences of the practice, the Court held that these arrangements are invalid under the Sherman Act because such "restraints upon alienation have been generally regarded as obnoxious to public policy." *Dr. Miles*, 220 U.S. at 404. In his dissenting opinion, Justice Holmes rejected the majority's approach and argued that, in many circumstances, the public would "be served best by the company being al-

lowed to carry out its plan" to establish minimum resale prices. *Id.* at 412 (Holmes, J., dissenting).[3]

Following *Dr. Miles*, the Court adopted *per se* rules against other types of vertical restraints. In *Schwinn*, the Court held that vertical nonprice restraints, such as restrictions on the territories or customers that distributors may serve, are *per se* unlawful. 388 U.S. at 379-80. As in *Dr. Miles*, the Court based this *per se* rule on the "ancient rule against restraints on alienation," rather than on economic analysis. *Id.* at 380. The next year, the Court held that vertical maximum price restraints are *per se* unlawful, based on similar concerns for protecting dealer freedom. *See Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968).

When the Court had occasion to reexamine these *per se* rules in light of modern economic analysis, however, it determined that vertical agreements often have procompetitive effects and are therefore more appropriately evaluated on a case-by-case basis under the rule of reason. In *Sylvania*, for example, this Court overturned *Schwinn*'s *per se* rule against vertical nonprice restraints, and expressly rejected the notion that the common-law rule against restraints on alienation could justify a *per se* rule of antitrust liability. *Sylvania*, 433 U.S. at 53 n.21. The Court explained that "the state of the common law 400 or even 100 years ago is irrelevant to the issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." *Id.* (internal quotation marks omitted). Instead, "[*p*]*er se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive." *Id.* at 49-50. The Court further explained that *per se* analysis is ill-suited to vertical restrictions "because of their potential for a simultaneous re-

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[3] *See also id.* ("I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get.").

duction of intrabrand competition and stimulation of interbrand competition." *Id.* at 51-52. In light of this potential for procompetitive effects, the Court concluded that the validity of vertical nonprice restraints should be determined under the rule of reason. *Id.* at 58.

Similarly, in *Khan*, this Court unanimously overruled its holding in *Albrecht* that vertical maximum price restraints are *per se* unlawful. As in *Sylvania*, the Court explained that concerns with "dealer freedom" are not an appropriate basis for a *per se* rule of antitrust liability. *Khan*, 522 U.S. at 16-17. Instead, the Court held that *per se* treatment is only "appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Id.* at 10 (internal quotation marks omitted). Building on the critiques of *Albrecht* offered by lower courts and commentators, the Court concluded that the *per se* rule should be rejected because there is "insufficient economic justification for *per se*" treatment of vertical maximum price restraints. *Id.* at 18.

2. The reasoning of this Court's decisions in *Sylvania* and *Khan* severely undermines the rule of *Dr. Miles*. The Court's focus, nearly a century ago, on "restraints on alienation" is no longer a valid basis for a *per se* rule of antitrust law. Instead, a *per se* rule is appropriate *only* for "conduct that would always or almost always tend to restrict competition and decrease output." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (internal quotation marks omitted).

This Court has identified certain prerequisites to application of a *per se* rule in the antitrust context. First, a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *Sylvania*, 433 U.S. at 58-59; *see also Sharp*, 485 U.S. at 724. Second, *per se* treatment is appropriate only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (inter-

nal quotation marks omitted). The Court has thus "expressed reluctance to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.'" *Id.* (quoting *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 458-59 (1986)). As discussed below, the *per se* rule of *Dr. Miles* satisfies neither of these criteria.

B. There Are No Demonstrable Economic Effects That Support *Per Se* Treatment Of Resale Price Maintenance.

In both *Sylvania* and *Khan*, this Court examined the economic effects of the vertical restraints at issue, including by considering "scholarly and judicial authority supporting their economic utility." *Sylvania*, 433 U.S. at 57-58; *see also Khan*, 522 U.S. at 15-19. Based on that examination, the Court found "insufficient economic justification" for *per se* treatment of vertical nonprice and vertical maximum price restraints. *Khan*, 522 U.S. at 18; *see also Sylvania*, 433 U.S. at 57-58. The same result is required in the context of resale price maintenance. Indeed, economic and legal scholars have reached an unusually strong consensus in support of the conclusion that resale price maintenance has a number of procompetitive uses and effects that, if permitted by the antitrust laws, could enhance consumer welfare. *See, e.g.*, ABA Antitrust Section, *Antitrust Law and Economics of Product Distribution* 76 (2006) (the "bulk of the economic literature on RPM . . . suggests that RPM is more likely to be used to enhance efficiency than for anticompetitive purposes").[4]

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[4] *See also* 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1611 (2d ed. 2004); Robert H. Bork, *The Antitrust Paradox* 289 (1978); Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance* 1-5, *at* http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf (forthcoming 2007); Posner, *Antitrust Law*, *supra*, at 172; David A. Butz, *Vertical Price Controls with Uncertain Demand*, 40 J.L. & Econ. 433, 455-57 (1997); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 72

1. Vertical Price And Nonprice Restraints Often Have Procompetitive Effects On Interbrand Competition.

A simplistic—and incorrect—criticism of vertical restrictions (including both price and nonprice restraints) is that they limit intrabrand price competition, raise retailers' margins, often raise retail prices, and are therefore harmful to consumers. That analysis, however, is wrong as a matter of economics and inconsistent with this Court's analysis of vertical restraints.

In *Sylvania*, the Court recognized that manufacturers often use vertical restraints to create incentives for their dealers to provide service and promote the manufacturer's product, which, in turn, fosters interbrand competition:

> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide ser-

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(1993); Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597, 617 (1993); Frank H. Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 146-48 (1984); Overstreet, *supra*, at 11.

> vice and repair facilities necessary to the efficient marketing of their products.

433 U.S. at 54-55 (citation and footnote omitted). As the Court noted, "these services might not be provided by retailers in a purely competitive situation" because of "market imperfections such as the so-called 'free rider' effect." *Id.* at 55.

In *Sharp*, the Court emphasized that "vertical nonprice restraints only accomplish the benefits" to interbrand competition identified in *Sylvania* "*because they reduce intrabrand price competition* to the point where the dealer's profit margin permits provision of the desired services." *Sharp*, 485 U.S. at 728 (emphasis added). And, as the Court stated in *Sylvania*, interbrand competition is the "primary concern of antitrust law." 433 U.S. at 52 n.19; *see also* Bork, *supra*, at 290; Overstreet, *supra*, at 48.

Moreover, as this Court explained in *Sylvania*, a manufacturer has no interest in overcompensating its retailers by enabling fat retail margins—to the contrary, "a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues." 433 U.S. at 56 n.24. Accordingly, "manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products." *Id.* at 56; *see also* Bork, *supra*, at 290 ("No manufacturer or supplier will ever use either resale price maintenance or reseller market division for the purpose of giving the resellers a greater-than-competitive return. . . . The manufacturer shares with the consumer the desire to have distribution done at the lowest possible cost consistent with effectiveness.").

Notably, a manufacturer uses many tools to enhance its interbrand competitive position that might increase nominal

prices to consumers.[5] Manufacturers may engage in national advertising or upgrade their product features, the costs of which get passed through to consumers in the form of increased prices—yet no one would argue that this conduct in a competitive marketplace is an anticompetitive activity. *See* Elzinga & Mills, *supra*, at 8-9; Easterbrook, *supra*, at 141. The presence of *inter*brand competition assures that manufacturers' actions to promote their products—including vertical distribution restraints—are geared toward efficiency and procompetitive results. *Sylvania*, 433 U.S. at 52 n.19, 56 n.24. If the manufacturer takes actions that boost prices without promotional benefits that consumers desire, it will lose sales to its interbrand competitors. *Id.*; Overstreet, *supra*, at 48. On the other hand, if the manufacturer's sales increase because consumers are getting more services that they value, then consumers benefit. Elzinga & Mills, *supra*, at 9.

Vertical price and nonprice restraints can both be used to enhance interbrand competition in this manner. Indeed, "there is a substantial body of economic analysis supporting the view that the distinction" between vertical price and nonprice restraints "is largely illusory." ABA Antitrust Section, *supra*, at 59; *see also Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) ("the economic effect" of "price and nonprice restrictions" is in many cases "similar or identical"). As Justice White explained in his concurrence in *Sylvania*, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of al-

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[5] While the use of resale price maintenance may lead to higher nominal retail prices, empirical analysis has shown that the practice can, in some situations, actually result in *lower* retail prices, in addition to the proconsumer benefits of increased services stimulated by the practice. *See* Overstreet, *supra*, at 138-40. For example, if resale price maintenance allows a manufacturer to compete more effectively and thereby expand its sales and output, the manufacturer may achieve efficiencies in manufacturing or distribution that could allow it to lower its unit costs and prices. *See id.* at 47-48.

lowing vertical nonprice restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). Indeed, the procompetitive uses of vertical territorial restraints to reduce intrabrand price competition identified by this Court in *Sylvania* and *Sharp* as supporting rule-of-reason treatment are equally applicable to resale price maintenance. *Id.* at 69-70; Posner, *Antitrust Law*, *supra*, at 184 ("any argument for the legitimacy of exclusive territories applies equally to resale price maintenance").

It is thus untenable that resale price maintenance should continue to be treated under a vastly different legal standard than all other vertical restraints. As Judge Bork wrote, "This field of law can be made clear, internally consistent, and congruent with reality only when we face the fact that the premise laid down in *Dr. Miles* . . . is incorrect and must be rejected." Bork, *supra*, at 298. The divergence in treatment of these similar vertical restraints, standing alone, is a strong reason for the Court to reexamine the rule of *Dr. Miles*.

2. There Are Many Uses Of Resale Price Maintenance That Can Enhance Interbrand Competition And Consumer Welfare.

It is well-accepted among legal and economic scholars that resale price maintenance, if permitted by the antitrust laws, would frequently be used for procompetitive purposes, such as providing incentives to retailers to stock and promote the manufacturer's products. *See, e.g.*, Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 81 (1998) ("[P]rice floor restraints are used in most cases unilaterally by a manufacturer to change the mix of price and non-price competition among retailers of its product. Restrictions on distribution are a means of competing on product quality."). "[N]o single specific theory explains all instances of [resale price maintenance]"—instead, there are a number of different purposes for which a manufacturer might implement resale price maintenance that are likely to have procompetitive virtues and en-

hance consumer welfare. Winter, *supra*, at 70. The common thread among these uses is that the manufacturer provides its retailers with a guaranteed margin as a means to enhance its competitive position against interbrand rivals.

The most commonly cited justification for resale price maintenance is that a manufacturer might impose a price floor to ensure that dealers provide demand-creating services. *See, e.g.*, Elzinga & Mills, *supra*, at 3; Overstreet, *supra*, at 49; Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 91 (1960). In the absence of resale price restraints, free-rider problems may diminish retailers' incentives to provide these services, harming the manufacturer and dampening interbrand competition. *See, e.g.*, Posner, *Antitrust Law*, *supra*, at 173.

Even outside the classic free-rider situation, resale price maintenance may be used by a manufacturer to provide its retailers with incentives to compete on service, where the retailer might otherwise have an inherent bias to rely too much on low prices (and not enough on service or promotional activities) to attract customers, which could reduce the manufacturer's overall interbrand competitive position. *See* Winter, *supra*, at 62-64. While a manufacturer might theoretically contract with its retailers to provide certain services, the transaction and monitoring costs associated with such a program can be prohibitive, and it can be far more efficient for a manufacturer to encourage retailers to compete on service by limiting intrabrand price competition. *Id.*

A manufacturer may also use resale price maintenance to encourage retailers to stock its products by guaranteeing a minimum resale margin, essentially "purchas[ing] shelf space in higher cost retail outlets." Overstreet, *supra*, at 47. The ability to "purchase" shelf space through resale price maintenance can be particularly important for a new or small manufacturer trying to break into the marketplace. *See, e.g.*, Mathewson & Winter, *supra*, at 60 ("In markets where extensive distribution systems are necessary, RPM is often used in the early part of a product's life cycle to aid in the estab-

lishment of the distribution system. In this situation, . . . RPM lowers the barriers of entry into upstream markets.").

Similarly, a manufacturer may use resale price maintenance to encourage its retailers to purchase more of its products, particularly in industries in which excess inventory can be subject to heavy discounting (such as the women's fashion industry, in which Leegin competes). Resale price maintenance ensures that retailers will be protected from a dramatic devaluation of their inventory when demand is unexpectedly low and, consequently, it reduces the chance that risk-averse retailers will purchase too little out of concern for having unsold stockpiles at the end of the season. *See, e.g.*, Butz, *supra*, at 451-52. A manufacturer, in turn, might use resale price maintenance to expand output or introduce more innovative products because retailers would be more willing to carry its products, enhancing interbrand competition and benefiting consumers. *Id.* at 457.

3. The Possibility That Resale Price Maintenance Might Be Used By A Cartel Does Not Justify The Rule Of *Dr. Miles*.

Of course, not every use of resale price maintenance is necessarily procompetitive. It is possible, for example, that resale price maintenance (just like vertical territorial restraints) might be used to enforce a horizontal agreement among dealers or manufacturers. *See* Posner, *Antitrust Law*, *supra*, at 183-85. The conditions in which such a cartel might theoretically operate, however, are extremely rare. Elzinga & Mills, *supra*, at 5-6; Easterbrook, *supra*, at 141-43. And, as demonstrated by empirical studies, instances of resale price maintenance being used for procompetitive purposes are "far more common" than instances in which it is used to facilitate a cartel. Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 282 (1991); *see also* Overstreet, *supra*, at 162 (empirical evidence "suggests that neither supplier nor dealer collusion explanations are likely to apply to all or even most instances of price maintenance").

There is neither an empirical nor a theoretical basis to conclude that consumers or competition benefit from a ban on *all* uses of resale price maintenance out of a concern over potential collusive uses of the practice, which could only exist under specific and uncommon market conditions. To the contrary, the empirical evidence "suggest[s] that, on the margin, the dominant effect of a relaxation of the per se prohibition of RPM would be a reduction in the deterrence of non-collusive uses of RPM." Ippolito, *supra*, at 292. Moreover, this Court's precedents do not support applying a *per se* rule that ensnares substantial procompetitive conduct simply out of fear of occasional anticompetitive uses. As discussed above, *per se* rules are appropriate *only* where a practice always, or almost always, results in anticompetitive effects. *See Sharp*, 485 U.S. at 723; Easterbrook, *supra*, at 142-43.

In any event, there is no reason to believe that the existing *per se* rules against horizontal collusion and the methods of detecting and punishing such collusion are so lacking as to justify additional *per se* rules as a prophylactic measure to bolster cartel enforcement. This Court addressed a similar issue in *Sylvania*, in which it noted that "[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers." 433 U.S. at 58 n.28. The Court concluded, however, that "we do not regard the problems of proof as sufficiently great to justify a *per se* rule." *Id.* The same reasoning requires rejection of the argument that a fear of cartels can support a *per se* rule against vertical price restraints.

4. Leegin Used Resale Price Maintenance For Procompetitive Purposes.

The facts of this case powerfully illustrate the competition-enhancing potential of resale price maintenance. Indeed, there is no allegation, evidence at trial, or even a realistic possibility that Leegin's conduct was part of a collusive horizontal scheme. *See* Elzinga Report at 14-18 (App., *infra*, at 31a-35a). There is also no evidence or suggestion that Leegin had market power. To the contrary, Leegin is but a

small player in the fragmented and highly competitive marketplace for women's fashion accessories. *Id.* at 16-20 (App., *infra*, at 33a-37a). In these circumstances, there is no realistic possibility that Leegin's use of resale price maintenance could harm consumers. *See id.* at 26-27 (App., *infra*, at 43a-44a).

Leegin used resale price maintenance in an attempt to bring new products and services to consumers and to use small retailers to compete against prominent national brands sold through department stores and other large outlets. *See* Elzinga Report at 10-12 (App., *infra*, at 27a-29a). This case presents precisely the circumstances in which resale price maintenance can *enhance* interbrand competition and consumer welfare. Indeed, the fact that Leegin's output grew substantially while its pricing policy was in effect indicates strongly that competition was enhanced and that consumers have benefited from the policy. *Id.* at 20 (App., *infra*, at 37a); *see also* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981) ("If [the defendant's] output expanded, the restriction must have made the firm's product more attractive on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition."); Easterbrook, *supra*, at 163-64. Holding Leegin's conduct to be *per se* unlawful stifles the competitive behavior of a small and innovative company, and thus conflicts with the objectives that this Court has sought to promote in interpreting the antitrust laws.

C. There Is No Judicial Experience With Resale Price Maintenance That Could Enable The Court To Predict With Confidence That The Rule Of Reason Will Condemn It.

This Court has often repeated that a *per se* rule is only appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (inter-

nal quotation marks omitted); *see also Broadcast Music, Inc. v. Columbia Broadcast Sys.*, 441 U.S. 1, 20 n.33 (1979). Continued adherence to the *per se* rule against resale price maintenance conflicts with this important criterion for the use of *per se* rules.

The rule of *Dr. Miles* was not the product of judicial experience evaluating resale price maintenance under the rule of reason. Indeed, the *Dr. Miles* Court offered no analysis of the practice's effect on competition or consumers, but instead simply applied the common-law prohibition on "restraints upon alienation." 220 U.S. at 404. And in the nearly 100 years since *Dr. Miles* was decided, the *per se* rule against resale price maintenance has prevented lower courts from developing experience in applying the rule of reason to assess resale price maintenance. *See* Ippolito, *supra*, at 268-69. In this case, for example, the district court conducted no analysis of the competitive effects of resale price maintenance on the marketplace, and it prevented Leegin from introducing any evidence or expert testimony regarding such effects.

Even more significantly, if courts *had* developed experience applying the rule of reason to resale price maintenance, that experience would not have justified a *per se* rule—either at the time of *Dr. Miles* or today. For example, in the late 19th and early 20th centuries, a number of courts evaluated resale price maintenance under the rule of reason and concluded that the practice did *not* harm competition. As the Washington Supreme Court explained:

> In the absence of a monopoly . . . a contract fixing retail prices to the consumer cannot have an effect appreciably inimical to the public interest because it cannot fix prices at an unreasonably high figure without defeating its own purpose by either signally failing to maintain the fixed price, or putting the individual manufacturer out of business. . . . [I]t seems to us an economic fallacy to assume that the competition which, in the absence of monopoly, benefits the public, is

> competition between rival retailers. The true competition is between rival articles . . . .

Fisher Flouring Mills Co. v. Swanson, 137 P. 144, 148, 151 (Wash. 1913).[6]

More recently, this Court has pointed to the procompetitive virtues of vertical agreements that enhance interbrand competition and benefit consumers by limiting intrabrand price competition. As the Court explained in *Sharp*:

> [V]ertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because *they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services*. As we described it in *Monsanto* [*Co. v. Spray-Rite Service Corp.*]: "The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that 'free-riders' do not interfere."

Sharp, 485 U.S. at 728 (quoting *Monsanto*, 465 U.S. at 62-63) (emphasis added). As Justice White recognized in his

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[6] *Accord Grogan v. Chafee*, 105 P. 745, 747 (Cal. 1909) ("There is nothing either unreasonable or unlawful in the effort by a manufacturer to maintain a standard price for his goods. . . . Contracts similar to the one under discussion have been considered in a number of cases, and have generally been upheld . . . ."); *Walsh v. Dwight*, 58 N.Y.S. 91, 93-94 (App. Div. 1899) ("[A] contract by a single manufacturer as to the price at which his goods . . . should be sold . . . would not be a contract by which competition in the supply or price of the commodity would be restrained or prevented. All of the manufacturers could compete with these defendants in the sale of these goods. . . . That such an agreement is not illegal has been settled by a long line of authorities."); *see also* Louis D. Brandeis, *Competition That Kills*, Harper's Weekly, at 11 (Nov. 15, 1913) ("abundant experience establishes that the one-price system . . . [has] greatly increased the efficiency of merchandising, not only for the producer, but for the dealer and the consumer as well").

concurrence in *Sylvania*, this is precisely the same economic effect that is fostered by resale price maintenance, and treating nonprice restraints under the rule of reason thus "call[s] into question" the rule of *Dr. Miles*. *Sylvania*, 433 U.S. at 69-70 (White, J., concurring).[7]

In light of the procompetitive benefits of resale price maintenance—which are the same benefits that motivated the *Sylvania* Court to apply the rule of reason to nonprice restraints—this Court should grant certiorari to reconcile the conflict between *Dr. Miles*'s *per se* prohibition on resale price maintenance and later decisions applying the rule of reason to analogous vertical agreements.

II. THE CONTINUING VITALITY OF THE RULE OF *DR. MILES* IS AN ISSUE OF SUBSTANTIAL PRACTICAL IMPORTANCE.

The question presented in this case has significant real-world economic implications because, contrary to the "primary purpose of the antitrust laws" (*Sharp*, 485 U.S. at 726), the *per se* prohibition against resale price maintenance stifles interbrand competition, and thus harms consumers, in the name of protecting dealer freedom.

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[7] Several lower courts have likewise noted the substantial potential for resale price maintenance to be used for procompetitive purposes, and have questioned the continued *per se* treatment of the practice. *See, e.g.*, *Khan v. State Oil Co.*, 93 F.3d 1358, 1364 (7th Cir. 1996) (noting that the rule of *Dr. Miles* is not "easy to defend in terms of economic theory or antitrust policy"), *rev'd on other grounds*, 522 U.S. 3 (1997); *id.* ("[V]ertical minimum price fixing . . . does not impair any interest that the antitrust laws interpreted in light of modern economics could be thought intended to protect. It increases rather than reduces competition . . . ."); *Pace Elecs., Inc. v. Canon Computer Sys., Inc.*, 213 F.3d 118, 123 n.4 (3d Cir. 2000) (noting that "various scholars have taken issue with the Supreme Court's *per se* treatment of vertical minimum price fixing agreements and argued that these agreements may have significant, procompetitive attributes").

As discussed above, in the absence of the *per se* prohibition on resale price maintenance, manufacturers could use the practice to compete against interbrand rivals. Indeed, the economic literature suggests that resale price maintenance, if permitted by the antitrust laws, would be used with some frequency. *See* Winter, *supra*, at 61 ("up to 10 percent of all retail products in the United States were subject to resale price floors" when state "Fair Trade" laws permitted resale price maintenance); Overstreet, *supra*, at 6-7 (same).

Because of the *per se* rule of *Dr. Miles*, however, manufacturers do not have this competitive tool at their disposal. Instead, they must turn to other restraints to achieve their desired mix of price and service promotion, such as establishing exclusive territories for dealers to prevent free-riding; integrating forward into distribution; or contracting for particular sales-related services. These other tools, however, are not cost-free, and a legal regime that forces businesses to select second-best tools to achieve their competitive ends is inherently inefficient. *See* Posner, *Antitrust Law*, *supra*, at 185; Butz, *supra*, at 443-46, 457; *see also Dr. Miles*, 220 U.S. at 412 (Holmes, J., dissenting) ("The Dr. Miles Medical Company knows better than we do what will enable it to do the best business."). Continued adherence to the rule of *Dr. Miles* thus forces inefficient choices on businesses that would otherwise compete using resale price maintenance. *See* Butz, *supra*, at 447 (in choosing among options to limit control of their distribution systems, manufacturers "have incentives to adopt the lowest-cost approach"). The increased costs from such inefficiency are ultimately borne by consumers.[8]

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[8] It is no cure for the ills of *Dr. Miles* that a manufacturer may unilaterally announce a suggested resale price and terminate noncompliant dealers. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The line between enforcing a unilateral policy and a *per se* illegal agreement can be uncertain. Businesses that rely on *Colgate* run the risk that a jury will later find that they crossed that line, as happened in this case. Moreover, the *Colgate* doctrine is a very blunt instrument. Manufacturers are likely to find it more efficient to enter into an agreement with their dealers that

Moreover, the rule of *Dr. Miles* imposes a particularly heavy burden on the many small businesses or new entrants that would use resale price maintenance to compete against larger incumbents. *See, e.g., Sylvania*, 433 U.S. at 65 (White, J., concurring) ("the potential benefits of vertical restraints in promoting interbrand competition are particularly strong where the manufacturer imposing the restraints is seeking to enter a new market or to expand a small market share"). Smaller competitors—such as Leegin—could use resale price maintenance as a valuable tool to encourage retailers to promote their products. Such companies, however, may be unable to bear the added cost of using less efficient tools to achieve their competitive ends. *See, e.g.*, Butz, *supra*, at 456-57 ("policies designed to promote intrabrand price competition by restricting vertical price controls may force marginally profitable firms out of business, thereby reducing both product variety and interbrand competition"). By contrast, larger competitors may enjoy sufficient brand recognition and clout with retailers that they do not need to employ resale price maintenance; and where they need to enforce minimum resale prices, they may be better suited to bear the increased costs of alternative solutions (such as integrating forward into distribution) that are not subject to *per se* prohibition. *See, e.g.*, Brandeis, *supra*, at 12 ("The great corporation with ample capital . . . can establish its own agencies or sell direct to the consumer, and is in no danger of having its business destroyed by price-cutting among retailers. But the prohibition of price-maintenance imposes upon the small and independent producers a serious handicap.").

A *per se* rule that favors larger incumbents at the expense of smaller competitors, new entrants, and innovators,

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governs the terms of their relationship, rather than having no option but to terminate noncompliant dealers. It is also ironic that the law now places manufacturers in the position of having to terminate dealers in order to enforce a vertical restraint that is designed to enhance retail services.

and that pushes manufacturers to integrate forward into distribution rather than use independent distributors, is antithetical to any rational principle of antitrust law.

III. THE ARGUMENTS FOR RETAINING THE RULE OF *DR. MILES* ARE INSUFFICIENT TO JUSTIFY ITS CONTINUED EXISTENCE.

In the lower courts, PSKS argued for retaining the rule of *Dr. Miles* based on considerations of *stare decisis* and deference to various congressional actions (or inactions) that did not actually require continued *per se* treatment of resale price maintenance. This Court has previously rejected similar arguments in overturning analogous *per se* rules, and it should not allow these considerations to stand in the way of a long-overdue reexamination of the rule of *Dr. Miles*.

A. *Stare Decisis* Is Not A Basis For Leaving Outdated *Per Se* Rules In Place.

In *Khan*, this Court expressly rejected the argument that it should leave undisturbed the antiquated and economically unsound *per se* rule against vertical maximum price restraints based on considerations of *stare decisis*. 522 U.S. at 20-21. The Court explained that "*stare decisis* is not an inexorable command" and that, "[i]n the area of antitrust law, there is a competing interest, well-represented in this Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Id.* Similarly, in *Sharp*, the Court recognized that "[t]he Sherman Act adopted the term 'restraint of trade' along with its dynamic potential," and therefore the "line of *per se* illegality" should not "remain[] forever fixed where it was" when the Sherman Act was enacted in 1890. 485 U.S. at 732.

This understanding of the dynamic nature of the Sherman Act is faithful to Congress's intent, and it has been an important part of the Court's antitrust jurisprudence for well over a century. *See, e.g.*, 21 Cong. Rec. S2456-60 (daily ed. Mar. 21, 1890) (statement of Sen. Sherman) (noting that the courts should "determine in each particular case" the "precise

line between lawful and unlawful combinations").[9] Indeed, in *Dr. Miles* itself, the Court stated that, "[w]ith respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions." 220 U.S. at 406; *accord Khan*, 522 U.S. at 21. Nothing in the Sherman Act or the history of this Court's decisions requires that the "adaptation to modern conditions" be frozen in place in 1911.

B. Congress Has Never Required Adherence To The Rule Of *Dr. Miles*.

In the lower courts, PSKS placed heavy reliance on arguments that the *per se* rule of *Dr. Miles* should be retained because of various actions or inactions by Congress over the course of the last century. This argument, however, provides no basis to refrain from reexamining the rule of *Dr. Miles* in light of modern economic understanding.

Congress's failure to legislatively overturn the rule of *Dr. Miles* warrants little weight. Indeed, this Court expressly rejected an argument based on congressional inaction in *Khan*, stating that "we infer little meaning from the fact that Congress has not reacted legislatively to *Albrecht*." 522 U.S. at 19. The Court explained that "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted

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[9] *See also, e.g., Guardians Ass'n v. Civil Serv. Comm'n*, 463 U.S. 582, 641 n.12 (1983) (Stevens, J., dissenting) ("Congress phrased some older statutes in sweeping, general terms, expecting the federal courts to interpret them by developing legal rules on a case-by-case basis in the common law tradition. One clear example of such a statute is the Sherman Act. For that reason, in [*Sylvania*], the doctrine of *stare decisis* did not preclude the Court from overruling its prior decision in [*Schwinn*], even though Congress had not acted in the intervening decade." (citations omitted)); *Tex. Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1981) (Congress's intent in passing the Sherman Act "to allow courts to develop governing principles of law [is] unmistakably clear"); Easterbrook, *supra*, at 136-38.

view that Congress expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition." *Khan*, 522 U.S. at 20 (internal quotation marks omitted).[10]

The proper focus is not on any "inaction" by Congress, but whether Congress has taken any action to take away from this Court its traditional role of "giv[ing] shape to the [Sherman Act's] broad mandate" in light of "the lessons of accumulated experience." *Khan*, 522 U.S. at 20. Congress has not taken such action with respect to resale price maintenance. In particular, Congress has *never* passed legislation requiring that resale price maintenance be treated as *per se* unlawful. To be sure, resale price maintenance has been a subject of congressional action on several occasions. In 1937 and 1952, Congress passed legislation that removed resale price maintenance contracts from the reach of the Sherman Act if such contracts were valid under state laws. *See* Miller-Tydings Act, Pub. L. No. 75-314, 50 Stat. 693 (1937); McGuire Act, Pub. L. No. 82-542, 66 Stat. 631 (1952). In 1975, Congress repealed these acts. *See* Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801. The 1975 Act did *not*, however, require that resale price maintenance be deemed *per se* unlawful. Congress simply repealed an antitrust exemption and restored the ordinary state of antitrust law—judicial interpretation of what constitutes an unlawful "restraint of trade." *See* Posner, *Antitrust Law*, *supra*, at 189 ("Congress's action in repealing an antitrust immunity for resale price maintenance was not the same thing as outlawing the practice."); Easterbrook, *supra*, at 139-40. This legislation provides no basis to freeze in place the *per se* rules that existed in 1911, 1975, or any other year.

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[10] *See also Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978) ("Congress . . . did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.").

In the courts below, PSKS also pointed to a handful of additional measures that Congress has considered or passed in the last three decades; but, again, none of these measures limits this Court's mandate to determine what conduct constitutes an unlawful restraint of trade. For example, in the mid-1980s, Congress twice prohibited the Department of Justice from using appropriations to advocate for a reversal of the *per se* rule against resale price maintenance. *See* Pub. L. No. 99-180, 99 Stat. 1136 (1985); Pub. L. No. 98-166, 97 Stat. 1102 (1983). The appropriation provisions were not repeated in the next budget, and they have not been repeated since. That these budgetary restrictions were not renewed, and that no similar restraints have been in place for a number of years, suggests, if anything, that Congress deemed them undesirable after the short period in which they were in place. This hardly seems to be a basis to disrupt this Court's longstanding mandate to interpret the Sherman Act.

That Congress has not enacted legislation that would take away this Court's power to interpret the antitrust laws simply underscores the propriety of the approach to the Sherman Act that this Court has pursued for a century. As Chief Justice White wrote in the year that *Dr. Miles* was decided, the Court should continue to interpret the standards for what constitutes an unlawful restraint of trade as its understanding of what makes a restraint "unreasonable" evolves. *Standard Oil Co. v. United States*, 221 U.S. 1, 63-64 (1911).

IV. AT A MINIMUM, RESALE PRICE MAINTENANCE BY A MANUFACTURER WITH NO MARKET POWER SHOULD BE SUBJECT TO THE RULE OF REASON.

Even if this Court were to conclude that resale price maintenance should continue to be treated as *per se* unlawful under some circumstances, it should grant certiorari to reject the rigid, sweeping *per se* rule applied by the lower courts in this case. In particular, if the Court were to conclude that a concern over the anticompetitive effects of horizontal collusion were a sound basis to maintain some form of *per se* rule

against resale price maintenance—which we believe would be unjustified (*see supra* Section I.B.3)—such a *per se* rule should be limited to apply only where there is a clear likelihood of such anticompetitive effects. *See, e.g., Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 298 (1985) ("A plaintiff seeking application of the *per se* rule [against group boycotts] must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects.").

For example, the Court has limited the *per se* rules against group boycotts and tying arrangements to cases in which the defendants possess market power, because in the absence of market power, the conclusion that the practices are "virtually always likely to have an anticompetitive effect is not warranted." *Id.* at 296; *see also Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16-18 (1984). In contrast, the lower courts in this case applied the *per se* rule against resale price maintenance blindly, with no regard for the actual marketplace impact, no analysis whether Leegin had market power, no inquiry into Leegin's rationale for the practice, and no opportunity for Leegin to explain the procompetitive consequences of its actions. *See* App., *infra*, at 15a.

While the most appropriate treatment of the *per se* rule of *Dr. Miles* would be to overturn it in its entirety, at a minimum this Court should make clear that the *per se* rule should not apply where a plaintiff is unable to "present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects." *Nw. Wholesale*, 472 U.S. at 298. In particular, the economic community has reached a clear consensus that there is no realistic possibility that resale price maintenance instituted by a manufacturer without market power and without horizontal collusion could have anticompetitive effects.[11]

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[11] *See, e.g.*, Overstreet, *supra*, at 174-75 ("Firms with small market shares are unlikely to possess market power, and they are, therefore, unlikely to be able unilaterally to employ RPM with anticompetive [sic]

In this case, Leegin is a small manufacturer with no market power in an intensely competitive marketplace, and there is no allegation of horizontal collusion or of market conditions that would make collusion likely. There is simply no realistic threat that its use of resale price maintenance could have had anticompetitive effects. Thus, even under a more economically tenable and narrowed *per se* rule, Leegin's policy should have been evaluated under the rule of reason. Accordingly, the Court should grant this petition to reassess the lower courts' application of the *per se* rule against resale price maintenance—if such a *per se* rule should be deemed appropriate at all.

V. THIS CASE IS AN IDEAL VEHICLE THROUGH WHICH TO RECONSIDER THE RULE OF *DR. MILES*.

Despite the broad impact of the rule of *Dr. Miles*, this case presents a rare opportunity for this Court to address these issues. Indeed, because of the longstanding *per se* prohibition on resale price maintenance, most manufacturers avoid entering into such agreements with their dealers, even where the practice would be the most efficient means to achieve their competitive ends.

Moreover, when a manufacturer is accused of entering into a resale price maintenance agreement, there are powerful

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[Footnote continued from previous page]

effects. Unless there is evidence . . . from which some inference of supplier collusion seems proper, a presumption that a firm with small market share is motivated to impose RPM by efficiency considerations is probably correct."); Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 Antitrust L.J. 83, 103 (1995) (where a small firm uses vertical restraints, there is "a strong case for use of vertical restraints because anticompetitive risks are low and alternative promotion techniques are unavailable"); Easterbrook, *supra*, at 159 ("if the defendant lacks market power, other firms can offer the customer a better deal, and there is no need for judicial intervention").

incentives for the manufacturer to settle the litigation because such cases present asymmetrical risks and rewards for the defendant, which may be defending its entire distribution system, and a plaintiff retailer, which may have nothing more at stake than damages in the litigation. Consistent with these incentives, empirical studies have demonstrated that a high percentage of resale price maintenance cases settle before conclusion. *See* Ippolito, *supra*, at 267, 273-74. This petition accordingly presents a rare opportunity for this Court to reexamine the rule of *Dr. Miles*.

Just as importantly, this case squarely presents the issue to this Court. Based on the *per se* rule of *Dr. Miles*, the district court prevented Leegin from presenting evidence of the procompetitive effects of its pricing policies, including the testimony of Leegin's economic expert. In addition, the district court instructed the jury, over Leegin's objection, that Leegin's pricing practices were *per se* unlawful, and it denied Leegin's motion for judgment as a matter of law based on the same conclusion. Leegin would clearly be entitled to a reversal if this Court overturned the rule of *Dr. Miles*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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October 4, 2006

APPENDIX

APPENDIX A

United States Court of Appeals,
Fifth Circuit.
PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes; Toni Cochran L.L.C., doing business as Toni's,
Plaintiffs-Appellees,

v.

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Defendant-Appellant.

No. 04-41243.

Decided March 20, 2006.

David Neil Smith, Nix, Patterson & Roach, Daingerfield, TX, Robert W. Coykendall, Ken M. Peterson, Morris, Laing, Evans, Brock & Kennedy, Wichita, KS, for Plaintiffs-Appellees.

Jeffrey Scott Levinger, Carrington, Coleman, Sloman & Blumenthal, Dallas, TX, Tyler Alexander Baker, III, G. Aaron Myers, Fenwick & West, Mountain View, CA, for Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Texas, (2:03-CV-107-TJW).

Before BARKSDALE and CLEMENT, Circuit Judges, and ENGELHARDT, District Judge.*

PER CURIAM:**

Leegin Creative Leather Products, Inc., primarily challenges application of the antitrust *per se* rule to its imposing a vertical minimum price-fixing agreement on its retailer, PSKS, Inc., doing business as Kay's Kloset . . . Kay's Shoes. Among other issues is the awarded damages' evidentiary basis. **AFFIRMED.**

I.

In 1995, Leegin, manufacturer of Brighton women's accessories, began selling its products to PSKS, a women's clothing and accessories specialty store. PSKS invested heavily in advertising and promoting the Brighton brand; by 1999, Brighton was PSKS' best-selling and most profitable line.

In 1997, Leegin instituted the "Brighton Retail Pricing and Promotion Policy", stating it would do business only with retailers following its suggested retail prices for Brighton products. In doing so, Leegin made clear it would not do business with retailers who engaged in discounting Brighton products they intended to reorder.

Leegin subsequently introduced the "Heart Store Program", a new marketing initiative designed to provide incentives to certain Brighton retailers to promote the brand within a separate section of their stores. To become a Brighton Heart Store, retailers had to pledge to "[f]ollow the Brighton Suggested Pricing Policy at all times".

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* District Judge of the Eastern District of Louisiana, sitting by designation.

** Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

In late 2002, after learning PSKS had violated Leegin's pricing policy by placing PSKS' entire line of Brighton products on sale, Leegin suspended all shipments of Brighton products to PSKS. As a result, its sales and profits decreased substantially.

PSKS filed this action against Leegin under § 1 of the Sherman Antitrust Act, 15 U.S.C. § 1: (1) claiming it entered into illegal agreements with retailers to fix Brighton products' prices and terminated PSKS as a result of those agreements; and (2) seeking future-lost-profits damages. (Co-plaintiff Toni Cochran, L.L.C.'s claims were dismissed at the close of plaintiffs' evidence. Cochran did not appeal.)

The jury found: Leegin and its retailers agreed to fix the retail prices of Brighton products; this caused PSKS to suffer antitrust injury; and PSKS was entitled to damages of $1.2 million. Pursuant to 15 U.S.C. § 15(a), the district court trebled the damages and awarded attorney's fees. Post-judgment, Leegin renewed its motion for judgment as a matter of law and moved for a new trial. The motions were denied.

II.

Leegin does *not* challenge the jury's finding it entered into price-fixing agreements. Instead, it challenges, *inter alia*, the application of the *per se* rule and the damages' evidentiary basis.

A.

Leegin claims the rule of reason should apply to PSKS' antitrust claims. This issue of law is reviewed *de novo*. *Craftsmen Limousine, Inc. v. Ford Motor Co.*, 363 F.3d 761, 772 (8th Cir. 2004) ("[A]lthough a court's determination that the *per se* rule applies might involve many fact questions, the selection of a mode [of analysis] is entirely a question of law.") (alteration in original; internal citation and quotation marks omitted). Each of the following three challenges fails.

1.

Leegin asserts: although the Supreme Court first applied the *per se* rule to vertical price fixing in *Dr. Miles Medical*

Co. v. John D. Park & Sons Co., 220 U.S. 373, 31 S.Ct. 376, 55 L.Ed. 502 (1911), it has not applied the rule consistently. The cases cited by Leegin in which the Court applied the rule of reason, however, did *not* involve a vertical minimum price-fixing agreement. *See State Oil Co. v. Khan*, 522 U.S. 3, 118 S.Ct. 275, 139 L.Ed.2d 199 (1997) (considering the validity of the *per se* rule against a vertical *maximum* price-fixing agreement); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 108 S.Ct. 1515, 99 L.Ed.2d 808 (1988) (applying the rule of reason to a vertical agreement that had the purpose and effect of increasing retail prices, but *without specifying the price to be charged*); *Cont'l T. V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977) (rejecting the *per se* rule for a vertical *non-price* restriction).

Because the Court has consistently applied the *per se* rule to such agreements, we remain bound by its holding in *Dr. Miles Medical Co. See also Simpson v. Union Oil Co. of Cal.*, 377 U.S. 13, 17, 84 S.Ct. 1051, 12 L.Ed.2d 98 (1964) ("[A] supplier may not use coercion on its retail outlets to achieve resale price maintenance".); *United States v. Parke, Davis & Co.*, 362 U.S. 29, 44, 80 S.Ct. 503, 4 L.Ed.2d 505 (1960) ("When the manufacturer's actions . . . go beyond mere announcement of his policy and the simple refusal to deal, and he employs other means which effect adherence to his resale prices, . . . he has put together a combination in violation of the Sherman Act."). In *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752, 769, 104 S.Ct. 1464, 79 L.Ed.2d 775 (1984) (Brennan, J., concurring), Justice Brennan commented on the Court's continued application of the *per se* rule, consistent with congressional intent, to distributor-termination cases in which there is a concerted action to set prices:

> As the Court notes, the Solicitor General has filed a brief . . . urging us to overrule the Court's decision in *Dr. Miles Medical Co.* . . . . That decision has stood for 73 years, and Congress has certainly been aware of its exis-

> tence throughout that time. Yet Congress has never enacted legislation to overrule the interpretation of the Sherman Act adopted in that case. Under these circumstances, I see no reason for us to depart from our longstanding interpretation of the Act.

2.

In the alternative, Leegin claims: its pricing policy did *not* result in competitive harm; therefore, it qualifies for an exception to the *per se* rule. Leegin asserts both the Supreme Court and this court have recognized exceptions to the rule's application in appropriate cases, citing *Broadcast Music, Inc. v. Columbia Broadcasting System, Inc.*, 441 U.S. 1, 99 S.Ct. 1551, 60 L.Ed.2d 1 (1979); *Abadir & Co. v. First Mississippi Corp.*, 651 F.2d 422 (5th Cir. Unit A July 1981); and *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351 (5th Cir. 1980).

As before, none of these cases involved vertical minimum price fixing. Furthermore, each was decided *before* the Court reaffirmed the *per se* rule's application to vertical minimum price-fixing agreements in *Sharp Electronics Corp.*, *Spray-Rite Service Corp.*, and *Khan*, as discussed *supra*.

3.

Leegin challenges the exclusion of its economic expert, who opined: (1) economic conditions did *not* dictate the *per se* rule's application; and (2) Leegin's pricing practices were pro-competitive, justifying the rule of reason's application. We review for abuse of discretion. *Watkins v. Telsmith, Inc.*, 121 F.3d 984, 988 (5th Cir.1997) ("District courts enjoy wide latitude in determining the admissibility of expert testimony, and the discretion of the trial judge and his or her decision will not be disturbed on appeal unless manifestly erroneous.") (internal citations and quotation marks omitted).

With the *per se* rule, expert testimony regarding economic conditions and the pricing policy's pro-competitive

effects is *not* relevant. *Viazis v. Am. Ass'n of Orthodontists*, 314 F.3d 758, 765 (5th Cir.2002) ("If application of the *per se* rule is appropriate, competitive harm is presumed, and further analysis is unnecessary."), *cert. denied*, 538 U.S. 1033, 123 S.Ct. 2078, 155 L.Ed.2d 1063 (2003); *see also N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5, 78 S.Ct. 514, 2 L.Ed.2d 545 (1958) ("[The] principle of *per se* unreasonableness . . . avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved . . . in an effort to determine . . . whether a particular restraint has been unreasonable".)

B.

Leegin claims PSKS did *not* prove antitrust injury, maintaining it is required under both the *per se* rule and the rule of reason. *Atl. Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 341-42, 110 S.Ct. 1884, 109 L.Ed.2d 333 (1990). Because antitrust injury *vel non* is a component of standing, we review *de novo*. *DeLong Equip. Co. v. Wash. Mills Electro Minerals Corp.*, 990 F.2d 1186, 1194 (11th Cir.), *cert. denied*, 510 U.S. 1012, 114 S.Ct. 604, 126 L.Ed.2d 569 (1993); *see also Doctor's Hosp. of Jefferson, Inc. v. Se. Med. Alliance, Inc.*, 123 F.3d 301, 305 (5th Cir.1997) ("Antitrust injury must be established for the plaintiff to have standing under section 1 . . . of the Sherman Act.").

1.

Antitrust "injury . . . [is what] the antitrust laws were intended to prevent and . . . flows from that which makes defendants' acts unlawful". *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489, 97 S.Ct. 690, 50 L.Ed.2d 701 (1977). "It ensures that the harm claimed . . . corresponds to the rationale for finding a violation of the antitrust laws in the first place." *Atl. Richfield Co.*, 495 U.S. at 342, 110 S.Ct. 1884.

In *Doctor's Hospital of Jefferson, Inc.*, 123 F.3d at 305, our court explained: "[A]ntitrust injury for standing purposes should be viewed from the perspective of the plaintiff's position in the marketplace, not from the merits-related per-

spective of the impact of a defendant's conduct on overall competition". Thus, antitrust injury is distinct from injury to competition, "the latter of which is often a component of substantive liability". *Id.*

PSKS suffered antitrust injury. Its refusal to follow Leegin's pricing policy resulted in inability to obtain its best-selling and most profitable product line. *See Pace Elecs., Inc. v. Canon Computer Sys., Inc.*, 213 F.3d 118, 124 (3d Cir. 2000) ("[A] dealer terminated for its refusal to abide by a vertical minimum price fixing agreement suffers antitrust injury and may recover losses flowing from that termination".).

2.

In the alternative, Leegin claims the district court erred by failing to instruct the jury on the definition of antitrust injury. Because such injury is a component of standing for the court's determination, this claim necessarily fails. *See Bell v. Dow Chem. Co.*, 847 F.2d 1179, 1182 (5th Cir. 1988) ("Antitrust injury is a component of the standing inquiry, not a separate qualification.").

C.

The jury awarded approximately 70 percent of the requested damages: $1.2, of the requested $1.7, million. Leegin contests the damages' evidentiary basis. The jury's award of antitrust damages is reviewed under a relaxed standard. *Bell Atl. Corp. v. AT & T Corp.*, 339 F.3d 294, 303 (5th Cir. 2003) ("[T]he nature of an antitrust claim means that some plaintiffs can only hypothesize about what the state of their affairs would have been absent the wrong . . . and we have, therefore, declined to hold antitrust plaintiffs to the same burden of proof of damages as demanded of plaintiffs in other civil cases".) (internal citations and quotation marks omitted); *Park v. El Paso Bd. of Realtors*, 764 F.2d 1053, 1067 (5th Cir. 1985) ("Once a plaintiff has proved by a preponderance of the evidence the fact of injury, a jury may use its discretion in determining the exact amount of damages resulting from the antitrust violation."), *cert. denied*, 474 U.S. 1102, 106 S.Ct. 884, 88 L.Ed.2d 919 (1986); *Malcolm v.*

Marathon Oil Co., 642 F.2d 845, 864 (5th Cir. Unit B Apr.) ("The relaxation of standards of proof are *particularly appropriate* in cases where the finder of fact *must estimate lost future profits*.") (emphasis added), *cert. denied*, 454 U.S. 1125, 102 S.Ct. 975, 71 L.Ed.2d 113 (1981).

In calculating damages, PSKS' expert averaged the gross profits PSKS earned from selling Brighton products in 2000 ($289,516), 2001 ($201,591), and 2002 ($141,458), concluding it would lose an estimated $210,855 in gross profits each year. (The decline in gross profits during 2001 and 2002 was attributed to: the 11 September 2001 terrorist attacks; and problems obtaining Brighton products in 2002.) That amount was multiplied by ten, the number of years PSKS' co-owner estimated it would take PSKS to recover from the termination of Brighton shipments, particularly because of the line's uniqueness. As discussed *infra*, PSKS offered evidence that net profits were the same as gross profits; the total was discounted to present value. Leegin did *not* offer an alternative method for calculating damages. *See Greene v. Gen. Foods Corp.*, 517 F.2d 635, 665 (5th Cir. 1975) (noting defendant's failure "to demonstrate any better method of lost future profits that could have been applied to the available data"), *cert. denied*, 424 U.S. 942, 96 S.Ct. 1409, 47 L.Ed.2d 348 (1976).

Obviously, it is impossible to prove PSKS' exact profits had Leegin not terminated its Brighton shipments. Instead, PSKS presented expert testimony, which "provide[d] a 'just and reasonable estimate of the damage based on relevant data.'" *Bell Atl. Corp.*, 339 F.3d at 303 (quoting *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264, 66 S.Ct. 574, 90 L.Ed. 652 (1946)). Accordingly, pursuant to our relaxed standard of review, each of the following four challenges fails.

1.

Leegin challenges the ten-year future-damages period. The expert relied on the above-referenced testimony that: it took PSKS ten years to find Brighton; the business grew very fast once that line was incorporated; and ten years was the

absolute minimum it would take PSKS to recover from the line's termination. This testimony by PSKS' co-owner was based on his 17-years experience building a profitable business.

The damages period is an issue for the jury. *Lehrman v. Gulf Oil Corp.*, 464 F.2d 26, 47 (5th Cir.) ("The duration of the period during which plaintiff might be expected to profit will vary from case to case; it is susceptible of no precise formulation, and must be left to the processes of the jury informed by the presentation of conflicting evidence."), *cert. denied*, 409 U.S. 1077, 93 S.Ct. 687, 34 L.Ed.2d 665 (1972).

2.

Leegin claims insufficient evidence for the lost net-profits calculation. In this regard, PSKS utilizes a point-of-sale system to track the direct costs and selling price of its inventory, allowing it to access information by an individual product or product line. PSKS' co-owner used this system to determine Brighton's contribution to PSKS' net profits during the three years prior to the termination, basing his projections on the average net profits during those three years. In doing so, he did *not* project any sales growth, despite testimony that the retail stores to which Leegin sold in 2003 experienced a 16-percent increase in revenues. Also, he did *not* consider profits from cross sales to customers who came to the store to purchase Brighton goods. Further, he testified gross and net profits were the same in this instance, because PSKS did not save costs as a result of its loss of the Brighton line.

Our court has approved future-profits estimates based on averages of past history. *See Malcolm*, 642 F.2d at 859-60. As noted, although PSKS' average profits from Brighton declined during the three years considered, this decline was attributed to the events of 11 September 2001 and PSKS' difficulty in obtaining Brighton products in 2002.

3.

Leegin maintains the damages model failed to account for mitigation of damages. It asserts PSKS profitably sold substitute products shortly after it lost the Brighton line. Leegin's representative, however, testified that, as early as 1998, she saw lines of handbags, shoes, and belts that competed with Brighton products.

The mere presence of competing products does *not* show they were substitutes for the Brighton line, or that their sale mitigated PSKS' loss. Its continued business of selling women's clothing and accessories, some of which are similar to the Brighton line, does not negate the lost profits incurred from its inability to sell Brighton products. *See Bhan v. NME Hosps., Inc.*, 669 F. Supp. 998, 1014 (E.D. Cal. 1987) (recognizing that providing an antitrust violator with immunity simply because the victim mitigated damages would contravene the goal of limiting anticompetitive conduct), *aff'd*, 929 F.2d 1404 (9th Cir.), *cert. denied*, 502 U.S. 994, 112 S.Ct. 617, 116 L.Ed.2d 639 (1991).

4.

Finally, Leegin claims the damages model impermissibly utilized a risk-free discount rate for the present-value award. "[T]he selection of a discount factor is a question of fact to be determined by the trier of fact". *Bridas S.A.P.I.C. v. Gov't of Turkmenistan*, 345 F.3d 347, 364 (5th Cir. 2003) (internal citations and quotation marks omitted), *cert. denied*, 541 U.S. 937, 124 S.Ct. 1660, 158 L.Ed.2d 357 (2004).

The jury was properly instructed to award only the present value of future damages. It heard testimony, including on cross-examination, regarding the rate utilized.

III.

For the foregoing reasons, the judgment is **AFFIRMED;** attorney's fees and expenses incurred for this appeal are **AWARDED** PSKS, pursuant to 15 U.S.C. § 15(a). This case is **REMANDED** to determine that amount.

AFFIRMED; ATTORNEY'S FEES and EXPENSES AWARDED FOR APPEAL; REMANDED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
MARSHALL DIVISION

PSKS, INC., ET AL.	§	
Vs.	§	CIVIL ACTION NO. 2:03-CV-107
LEEGIN CREATIVE LEATHER PRODUCTS, INC.	§	

ORDER

The defendant's motion for new trial (#108) and renewed motion for judgment as a matter of law (#109) are denied.

In the motion for new trial, the defendant contends that the court erred when it excluded the testimony of its economic expert. Despite the defendant's arguments, the court remains persuaded that its analysis of this case and, in particular, the rationale underlying the court's exclusion of Dr. Elzinga's testimony, is correct under current law. Nearly a century ago, *Dr. Miles* prescribed vertical minimum price fixing agreements unlawful under Section 1. *Dr. Miles Medical Co. v. John D. Park & Co.*, 220 U.S. 373 (1911). Whether the per se classification of such agreements is wise is not for this court to decide. A dealer terminated for discounting under the circumstances presented here suffers antitrust injury as a matter of law. *Pace Electronics, Inc. v. Canon Computer Systems, Inc.*, 213 F.3d 118, 124 (3d Cir. 2000). The defendant's arguments that the court should have

further defined antitrust injury or that a defense existed because the plaintiff could not prove injury to competition are indirect challenges to the per se classification of the violation. In addition, the court is not persuaded that the jury should have been instructed under *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351, 1361-1367 (5th Cir. 1980) that it could find an exception to the per se rule under the facts of this case. The court has canvassed the arguments made in the defendant's motion for new trial and is persuaded that the motion should be denied.

The court has also considered the arguments made in the defendant's renewed motion for judgment as a matter of law. To evaluate the motion for judgment as a matter of law, the court must keep in mind that the jury in this case found a violation of Section 1 on sufficient evidence. That said, the defendant's primary challenge is to the evidence supporting the damages verdict. The defendant contends that the plaintiff's damage model and supporting proof were impermissibly speculative. The court disagrees.

In an antitrust case, once the fact of damages has been proven, a plaintiff enjoys a somewhat relaxed burden of proof regarding the amount of damages. *Bigelow v. RKO Radio Pictures, Inc.*, 327 U.S. 251, 264 (1946). This is because it is not possible to compute future damages with mathematical precision and the wrongdoer should bear the burden of any uncertainty created by the illegal activity. *Story Parchment Company v. Paterson Parchment Paper Company*, 282 U.S. 555 (1931); *Lehrman v. Gulf Oil Corporation*, 464 F.2d 26, 46 (5th Cir. 1972) ("the courts are to take a charitable view of the difficulties of proving damages in a case when a treble-damage plaintiff must try to prove what would have accrued to him in the absence of the defendant's anticompetitive practice."). In a distributor termination case, the defendant's decision to cut off the source of supply forces an aggrieved plaintiff who seeks compensation for lost profits, in effect, to prove sales that he never had a chance to make. *Pierce v. Ramsey Winch Co.*, 753 F.2d 416, 435 (5th Cir. 1985). Although the standard is lenient, it is not without

limits: the plaintiff must not resort to guesswork or speculation. Instead, a plaintiff must provide a just and reasonable estimate of the damage based on relevant data. *Eleven Line, Inc. v. North Texas State Soccer Ass'n*, 213 F.3d 198, 206-07 (5th Cir. 2000).

Here, there is no substantial question that the plaintiff proved the fact of damages resulting from the termination of its supply. The defendant touts the Brighton brand as an attractive, unique product, made so at least in part by the company's pricing policies. The value of such a brand to a distributor is evident. Even when undertaken pursuant to the *Colgate* doctrine, one intended effect of suspending shipments to a dealer is to cause adverse economic consequences--to persuade, as the case may be, the discounter to reconsider its position. So it was in this case. The plaintiff proved the fact of damages.

As to the amount of damages, the court has reviewed the evidence under the prevailing standards and concludes that the jury could have credited or rejected the factual underpinnings of Mr. Davis's testimony, including the projected damages term and the benchmark average used to compute the subsequent annual losses. The average sales in particular were based on actual, not theoretical, numbers. Mitigation was also for the jury. The defendant's able lawyers subjected the plaintiff's principal and its expert witness to vigorous cross-examination on the merits of the damages issues in this case. The jury was properly instructed on the measure of damages, and it is significant that the jury did not award the entire amount sought by the plaintiff. Under the prevailing standards for antitrust damages, this award is supported by sufficient evidence. The court has reviewed the balance of the renewed motion for judgment as a matter of law and concludes that the motion should be denied.

So **ORDERED** and **SIGNED** this 17th day of August, 2004.

/s/

T. JOHN WARD
UNITED STATES DISTRICT JUDGE

APPENDIX C

U.S. Court of Appeals
FILED
July 19, 2006
Charles R. Fulbruge III
Clerk

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 04-41243

PSKS INC doing business as, Kay's Kloset . . . Kay's Shoes;
TONI COCHRAN LLC doing business as, Toni's

Plaintiffs - Appellees

v.

LEEGIN CREATIVE LEATHER PRODUCTS INC

Defendant - Appellant

Appeal from the United States District Court for the
Eastern District of Texas, Marshall

ON PETITION FOR REHEARING
AND REHEARING EN BANC

(Opinion 3/20/06, 5 Cir., _____, _____ F.3d _____)

Before BARKSDALE and CLEMENT, Circuit Judges, and ENGELHARDT, District Judge*.

PER CURIAM:

(X) The Petition for Rehearing is DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on Rehearing En Banc, (FED. R. APP. P. and 5TH CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) The Petition for Rehearing is DENIED and the court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor, (FED. R. APP. P. and 5TH CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service and not disqualified not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/

United States Circuit Judge

REHG-4A

* District Judge of the Eastern District of Louisiana, sitting by designation.

APPENDIX D

An Economic Analysis of the Antitrust Issues in:

PSKS, Inc. d/b/a/ Kay's Kloset, Kay's Shoes; and Toni Cochran, L.L.C., d/b/a/ Toni's

v.

Leegin Creative Leather Products, Inc.

before Judge T. John Ward
U.S. District Court for the Eastern District of Texas, Marshall Division
Civil Action No. 2-03-CV-107-TJW

Report of Kenneth G. Elzinga
Professor of Economics
University of Virginia

January 12, 2004

I. Introduction and Personal Background

I am the Robert C. Taylor Professor of Economics at the University of Virginia. Most of my teaching and research is in the field of antitrust economics. This report represents my economic analysis of the antitrust issues in *PSKS, Inc. d/b/a/ Kay's Kloset, Kay's Shoes; Toni Cochran, L.L.C., d/b/a/ Toni's v. Leegin Creative Leather Products, Inc* (hereafter Kay's, Toni's, Leegin). I have served in the Antitrust Division of the Department of Justice at the policy level and have lectured on several occasions to federal judges on antitrust economics. Currently I am a consultant to both the Antitrust Division and the Federal Trade Commission on major antitrust matters. I have been a testifying expert on antitrust cases that have gone to appellate courts, including the Supreme Court, and I have authored and co-authored dozens of scholarly publications on the economics of antitrust. Re-

cently I served as a special consultant to Judge Lewis A. Kaplan in the Christie's-Sotheby's Auction Houses Antitrust Litigation and I have been on the faculty for several years of the American Law Institute-American Bar Association course on Product Distribution and Marketing.

A copy of my curriculum vitae is attached as Exhibit 1. A list of the cases in which I have provided testimony in recent years is provided as Exhibit 2.

II. Assignment in this Case

I was asked by attorneys representing Leegin to conduct an economic analysis of the allegations made by the plaintiffs in this antitrust case. Plaintiffs claim that Leegin's Suggested Retail Price policy on its Brighton line of products affords Leegin "vertical pricing control to monopolize the market" and that the effect of Leegin's price policy is to "penalize the consumers of goods." In short, plaintiffs accuse Leegin of adopting and implementing a business model that "reduces competition." (Complaint, ¶14)

To carry out this assignment, my research was conducted at two general levels. The first involved understanding the economics of women's fashion accessories such as handbags, belts, and jewelry.[1] The second involved an economic analysis of Leegin's marketing practices to determine whether or not they enable Leegin to have "vertical pricing control to monopolize the market," "penalize the consumers of goods," or otherwise somehow "reduces competition."

In conducting my research, I considered the economic literature on vertical arrangements. I also interviewed Leegin management and visited Leegin's headquarters and production facility in City of Industry, California; in addition I visited retail accounts selling Leegin merchandise as well as re-

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[1] Leegin divides its products into nine lines: belts, handbags, wallets, watches, jewelry, eyewear, luggage, gifts, and other. In the trade, Leegin's products are often called "fashion accessories."

tailers selling merchandise that competes with Leegin's products. I also visited the California Market Center and The New Mart in Los Angeles where hundreds of vendors of purses, belts, jewelry and women's clothing display and sell their wares at wholesale. In the course of my research, I read documents produced in this litigation as well as trade publications. I was given free rein by Leegin's attorneys to complete this report.

Cornerstone Research, an economic consulting firm in Menlo Park, California, assisted me in my analysis. No resources of the University of Virginia were used in its preparation. A list of the materials I considered in forming the opinions found in this report is attached as Exhibit 3. Because discovery has not ended, I reserve the right to modify or supplement my opinions based upon additional information or further analysis.

III. Organization of Report

My report is organized as follows. Section IV defines the central objective of antitrust law as the promotion of consumer welfare and explains that consumer welfare is at the heart of my analysis of Leegin's pricing strategy. In Section V, the economic analysis of resale price maintenance is laid out and I apply this analytical framework to the business model of Leegin. In Section VI, I describe the situations where economists raise objections about resale price maintenance and I show that these concerns do not fit the markets in which Leegin operates. Section VII of my report explains the absence of any antitrust injury associated with Leegin's conduct and also contains an evaluation of the expert report submitted by plaintiffs. The final section summarizes my conclusion that the Leegin business model, including its use of Suggested Retail Prices, is procompetitive and, in addition, favorable to small business.

IV. The Consumer: The Focal Point of Antitrust Economics

The purpose of antitrust economics is to sort out economic wheat from economic chaff: to distinguish procom-

petitive business conduct, which promotes consumer welfare, from anticompetitive behavior, which reduces consumer welfare.[2] Procompetitive conduct by sellers benefits consumers by lowering market prices and/or raising product quality.[3] Anticompetitive conduct harms consumers by raising prices (which reduces quantities sold) or reducing product quality. In economic analysis, product quality includes tangible attributes, such as durability and workmanship, and intangible attributes, such as style, cachet, and the overall shopping experience associated with buying the product.

The distinction between anticompetitive and procompetitive practices does not turn on the impact of the practice on competitors. Whether business conduct is procompetitive or anticompetitive depends on how it affects consumers, not rivals. For example, the plaintiffs in this litigation allege that because of Leegin's business model, they are harmed. But this contention does not address whether *consumers* are being harmed. The guarantor of consumer welfare is competition

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[2] The chairman of the Federal Trade Commission, testifying before the House Judiciary Committee, put the matter this way: "It is virtually undisputed today that the purpose of antitrust is to protect consumers, that economic analysis should guide decisions, and that horizontal cases involving mergers and agreements among competitors are the mainstays of antitrust." Timothy J. Muris, Prepared Statement of July 24, 2003, available at www.ftc.gov/os/2003/07/antitrustoversighttest.htm.

[3] Consumer welfare can be thought of as the difference between what a consumer pays for a product in the marketplace and the most that consumer would be willing to pay for that same product rather than going without it. One can see that, by this definition, a reduction in a product's price, *other things remaining unchanged*, adds to consumer welfare. Similarly, higher quality and easier availability, at the same product price, add to consumer welfare. To monetize the value of higher quality or easier availability, an economist calculates the price reduction on the unenhanced product that would be necessary to raise consumer welfare as much as getting the enhanced product at the original price.

among rivals in the marketplace, not preserving the *status quo* among rivals.

V. The Economics of Resale Price Maintenance

When they first learn that manufacturers sometimes endeavor to maintain a minimum resale price for their products, my students at the University of Virginia often are puzzled. Their intuition suggests that a manufacturer, having sold a product to a retailer, would then want the product to be sold at the lowest price possible so that consumers would buy more of the product rather than less. When a manufacturer endeavors to maintain a minimum price at retail, or discourage "discounting" by retailers, two questions regularly come to students' minds:

> Why would a manufacturer seek to "maintain" a higher retail price for its product?
>
> If a manufacturer succeeded in maintaining a higher retail price, what are the consequences for consumer welfare?

With regard to the first question, there are several reasons why a manufacturer might have a policy in place that influences downstream pricing. With regard to the second question, some applications of a resale price maintenance policy *can* enhance consumer welfare; others may have the opposite effect. This means any economic assessment of the issues in this case must connect the facts with the applicable economic principles as they apply to Leegin's pricing practices.

Let me begin with a note on terminology. From the perspective of antitrust economics, the focal point of this case is Leegin's Suggested Retail Price (SRP) policy.[4] At times I

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[4] See Exhibit 4 for a copy of Leegin's "Brighton Retail Pricing And Promotion Policy," which explains that Leegin "stands firm" regarding its Suggested Retail Prices. The plaintiffs also allege that Leegin charged excessive freight costs in transporting goods for some retail accounts.

[Footnote continued on next page]

shall refer to Leegin's SRP policy as one of resale price maintenance (RPM).[5] Both SRP and RPM describe a manufacturer of a branded product endeavoring to influence the downstream resale price of the manufacturer's product or product line. Normally this resale price is at the retail level (as it is in this litigation).

Manufacturers selling undifferentiated products in perfectly competitive and frictionless markets would never use RPM as a pricing practice. In such markets, transactions are made at an equilibrium market price for identical products and the manufacturer has no continuing interest in the disposition of its output once it has been paid the market price.[6] But in many commercial transactions involving branded products, economic analysis teaches that RPM can be an efficient pricing practice that benefits consumers. As some antitrust scholars would put it, RPM limits *intrabrand competition* but enhances *interbrand competition*.[7] To understand the economic logic that explains how RPM can do this, two economic concepts must be introduced: (1) consumer de-

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[Footnote continued from previous page]

See Complaint ¶¶ 21-23. Since these claims involve breach of contract and fraud, and not antitrust, I do not address them in my analysis.

[5] My use of the term "resale price maintenance" is in its economic context. The existence of RPM, to an economist, does not by itself mean (or even suggest) that there is an "agreement" between a manufacturer who implements a resale price policy (such as Leegin's) and a retailer who charges those prices. The economic analysis of RPM does not pivot on the existence of a legal "agreement" between the upstream manufacturer and the downstream distributor.

[6] It is in this world where my students' instincts are correct: a manufacturer selling in such a market would want the lowest retail price possible since this would increase market volume.

[7] Intrabrand competition is a synonym for within-brand competition. Interbrand competition is a synonym for between-brand competition.

mand for a product depends on more than the product's price; (2) the free rider.

V. A. RPM as Demand-Shifter

In the world of differentiated consumer products, such as those at issue here, demand is a function of price, quality, design, and retail service.[8] When demand is a function of retail service, this means improvements in retail service raise consumer demand. Mathewson and Winter describe some of the sources of increased demand:

> Additional demand factors include: the number of outlets or availability of the product, the convenience of the outlet's location, the information provided to customers at the point of sale, the sales effort and talent of dealers, the reputation of the product for quality, the prominence of the display of the product and so on. . . . Protecting a higher retail margin increases the marginal benefit that each retailer gains from attracting an additional customer by providing service, and therefore increases the amount of service that each retailer will provide. The general "service hypothesis" is that the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher[]retail price."[9]

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[8] Retail service is defined broadly to include such variables as pre-sale display, product-specific information about a product, store hours, post-sale service, the reputation of the retailer as a certifier of product quality, and the overall shopping experience.

[9] Frank Mathewson and Ralph Winter, "The Law and Economics of Resale Price Maintenance," *Review of Industrial Organization*, Vol. 13, April 1998, p. 67, internal footnote omitted.

Economic theory shows that an increase in demand caused by increased retail service can make consumers better off, even if accompanied by a price increase.

To apply this to the *Leegin* litigation, economic analysis raises the prospect that the SRP policy of a firm like Leegin might influence retailer behavior so much (in promoting the Brighton product line) that the increase in consumer demand results in more product being sold despite a higher price. As a consequence, consumer welfare is increased. Put differently, economists recognize that retail service, retail amenities, retail location, retail inventories, and retail information can all be components of consumer welfare. The economics of RPM teaches that it is incorrect to think that only low prices determine consumer welfare.

V. B. RPM and the Free Rider

It is instructive to ask why, absent a manufacturer's SRP policy, retailers would not have economic incentives to provide pre-sale and post-sale services "on their own" in any market in which consumers valued them? The answer economic analysis provides is the free rider. In economic lingo, the free rider is a form of "market failure." Manufacturers with SRP policies are trying to remedy this market failure. To understand Leegin's pricing policy from an economic perspective, it is necessary to understand the economics of the free rider.

A free rider is someone who enjoys the fruits of someone else's (costly) economic endeavors. The iconic free riding example is the high-tech, information-intensive consumer durable (think of high-end audio equipment) that requires considerable pre-sale information by a knowledgeable salesperson at a retail establishment to inform and persuade a consumer of the product's merits. Upon getting the requisite information at the full-service retailer, the shopper leaves the store without making a purchase, travels to a discount operation that stocks the product the consumer now knows she wants, and buys it for a lower price. The lower price is pos-

sible because the buyer and ultimate seller can free ride off the costs born by the full-service retailer.

In markets where free riding is common, sellers may reduce their participation because they are not provided adequate remuneration. Consumers may reduce their participation in such markets because they are not provided adequate pre- or post-sale services. The upshot is a reduction of output in such markets. In the extreme, the entire market for a desirable good (one where value exceeds opportunity cost) can go away because of free-riding. Consequently, free riding is not a sustainable (economists would say "equilibrium") market situation; it does not maximize consumer welfare. SRP policies that protect retail margins and thereby thwart the discounter are one way to eliminate the free rider problem. This is the solution that Leegin (and many other businesses) have adopted in various forms.

The free rider problem is not confined only to high-tech, information-intensive consumer durables.[10] RPM occurs in markets where goods do not require detailed information, extensive product demonstration, or significant post-sale service commitments. A Leegin bracelet or wallet would be an example. Other such products might include shirts, shoes, candy, and designer jeans. In the case of such products, retailers may use protected margins to invest in greater services (e.g., longer hours of operation, nicer store furnishings, additional sales force training) that signal or certify the quality of their merchandise.[11] This may increase the demand for the manufacturer's product, giving manufacturers of products

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[10] This is the form of free riding discussed in Lester Telser's pathbreaking article on protected retail margins. See "Why Should Manufacturers Want Fair Trade," Journal of Law & Economics Vol. 3, October, 1960, pp. 86-105, especially p. 91.

[11] The standard source is Howard Marvel and Stephen McCafferty, "Resale Price Maintenance and Quality Certification," *Rand Journal of Economics*, Vol. 15, Autumn, 1984, pp. 346-359.

that merit this treatment an incentive to have an SRP or RPM policy.[12] Once these investments in quality certification have been made, they are subject to free riding without an effective SRP or RPM policy. Free riding occurs when stores offer these products at a lower price, and can do so because they are free of the responsibility and expense of endorsing the products' quality.

Improving retail promotion of its Brighton product line and thwarting free riding is what Leegin endeavors to accomplish by its SRP pricing practice. The couple who founded Leegin began their business as a small independent retailer and this led the firm, as a manufacturer, to focus on independent retailers as a way of creating a distinctive brand of fashion accessories.[13] Leegin wanted a high-service shopping experience to be part of the Brighton brand and believed that independent retailers could provide those services.[14] The incentive a retailer has to develop and promote the Brighton brand comes in part through its quality and design signature; it also comes through Leegin's SRP policy, which means that the store would not engage in free riding.

In this lawsuit, Kay's and Toni's are classic free riders. They are not firms whose business model benefits consumer

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[12] Obviously, a product whose quality is low cannot survive in the marketplace if the product has been priced at a high retail margin. An RPM policy does not enable a manufacturer to make a silk purse out of a sow's ear.

[13] The one exception that proves this rule is Nordstrom's. Leegin had served this department store chain before its business model was refined and has continued its relationship with this retailer.

[14] My understanding is that many retailers today attest that the Brighton line gave them an entry point in competing against larger, established chain stores in the sale of belts, handbags, jewelry and other such products. In my visits to stores that sell Brighton products, I was struck by the attentive customer service and the retailers' enthusiasm for the Brighton line.

welfare. Quite the contrary, their failure to abide by Leegin's SRP policy will disincent other retailers from promoting the Brighton line. Over time, as the Brighton line becomes less valuable to consumers, it will become less valuable to retailers, including Kay's and Toni's as well. In the meantime, Kay's and Toni's would reap the fruits of free riding. If Leegin is forced off its business model, it will be a less viable competitor in women's fashion accessories.

Indeed, Mr. Phillip Smith, the owner (with his wife) of Kay's, noted in his deposition that "[h]e increased . . . purchases from [Brighton] by better than fifty percent" in the first six months after Kay's began heavily discounting Brighton products. (Oral Statement of Phillip Craig Smith, Sr., KK021608, 2/12/2003) Mr. Smith considers this to be evidence of the anticompetitive harm of Leegin's SRP policy. He has it exactly backwards. Kay's conduct squares with that of a free rider. Its sales jump, as a free rider's would, because other retailers are providing (in the short term) the marketing services that undergird and expand the market demand for Brighton products. If Kay's free-riding caused an erosion of margins for other retailers in the area, this would lead to a reduction in demand for Brighton products (since demand is in part a function of retail amenities).

What plaintiffs do not seem to understand is that Leegin's business model is not designed to enable retailers to gouge consumers nor is it designed to enable retailers to make monopoly profits off the Brighton brand. Leegin has no incentive to overcompensate its retailers. Doing so would reduce the profits Leegin might make *and* it would make Leegin merchandise less competitive in the marketplace. Leegin wants its retailers to "make as little money as possible" and still be willing and able to market the Brighton line attractively and effectively. Leegin's SRP policy permits Leegin to compensate its retailers for the level of service it wants Brighton customers to enjoy at the retail level; Leegin's objective in all this is to enhance *interbrand competition*.

To the extent that Leegin is mistaken about what consumers want, interbrand competition will discipline Leegin because the firm's SRP policy in no way insulates Leegin from the competition of other manufacturers who use different marketing strategies and distribution channels to vie for consumer patronage. Vigorous interbrand competition, and Leegin's incentive to be successful in this arena, determines the ultimate retail prices of Brighton merchandise.

It is one thing to acknowledge the economics of RPM and endeavor to explain that it does not apply to the facts of a particular situation. But here the plaintiffs' Complaint not only fails to consider the economic analysis of RPM, it reflects no awareness of this analysis. Nor does the December 5, 2003 report of plaintiffs' forensic accountant, Dr. James D. Woods. The absence of any economic analysis on the plaintiffs' side of this case is itself revealing. One is reminded of the Arthur Conan Doyle novel *Silver Blaze* where Sherlock Holmes made much of the dog that did not bark.

VI. Potential Negative Economic Consequences of RPM

Having set forth the standard economic analysis of RPM, and shown how Leegin's SRP policy benefits consumers, it is instructive at this juncture to consider the conditions where RPM does *not* shift consumer demand in a welfare-enhancing fashion and as a consequence has the potential to reduce consumer welfare. Economic analysis suggests three ways in which RPM can contravene antitrust's fundamental goal of promoting consumer welfare. Of the three public policy arguments against RPM, two involve the prospect of *cartel formation* in a market characterized by RPM. In the first instance, the cartel is formed at the level of downstream distributors (such as retailers); in the second, the cartel is formed at the level of the manufacturers -- but the cartel

makes use of RPM to strengthen the cartel.[15] Let me take these situations up and then turn to the third public policy argument against RPM.

VI. A. RPM-Induced Retailer Cartels

In the case of a cartel at the retail level, retailers behave collusively to get manufacturers to adopt policies that set resale prices at the cartel-optimum level for the retailers. Because manufacturers appear to be setting retail prices vertically, this diverts attention from the horizontal exercise of collective price-setting by the retailers. Furthermore, by inducing manufacturers to "impose" an RPM policy upon them, retailers in effect deter themselves from cheating on the agreement and competing on price themselves. In this scenario, retailers use manufacturers' RPM policy as a cover for their own cartel endeavors. Retailers thereby delegate part of the enforcement of the cartel to the manufacturer.

For RPM of this variety to work, retailers must possess what economic theory calls "monopsony power" and the manufacturer must go along with the practice even though its sales are reduced. Retailers must have the clout to cajole manufacturers to maintain retail prices, so the retailers need not enter into a direct price fix.[16]

How do consumers fare when RPM is used as the cat's paw for a retail cartel? They are made worse off, the same as

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[15] For a manufacturer, "downstream" could mean any point in the distribution chain from the manufacturer's shipping dock. For purposes of exposition, I refer to the downstream level as the retailer. It would not affect the analysis if I were to use wholesalers or other participants anywhere in the distribution channel from manufacturer to ultimate consumer.

[16] The simple model of an RPM-induced retail cartel does not explain or account for how retailers could avoid their cartel being undermined by other forms of competition, such as non-price rivalry or retailers undercutting the manufacturer's price minimum by offering free or discounted products contingent upon the purchase of the RPM good.

they would be if the cartel were operated directly by retailers without the participation of upstream manufacturers. The textbook example here is a cartel of retail druggists who, working through a trade association, cajoled the manufacturer of Pepsodent toothpaste to implement RPM. But there is no evidence that retailer-induced cartels are common.

There also is no prospect that a horizontal agreement among the hundreds of independent gift stores, women's apparel stores, and specialty shops that sell Brighton handbags, jewelry, belts and other items in the Brighton line could be effective. There are at least three reasons this is the case.

First, there are many small, geographically dispersed retailers that sell the Brighton line.[17] Leegin lists 2,879 retailers in 49 states and the District of Columbia that carry Brighton products. In Texas alone, Leegin serves 380 retailers, 137 of which are the only store carrying Brighton products in the town. In addition, there are many more retailers of women's fashion accessories that do not carry the Brighton line but carry competitive products. For example, according to the 1997 Economic Census, in Texas alone there were a total of 3,164 women's clothing stores, clothing accessories stores, and luggage and leather goods stores.[18]

Anyone who has been a student of cartels would realize how implausible it would be for all retailers of the Brighton product line to surmount the logistical complications of communicating with one another, deciding collectively what prices would be charged on the hundreds of items in the Brighton line, and then enlisting the Leegin management in the scheme so that Leegin's SRP policy could serve as "the front" for the retailer cartel. Moreover, the kind of retailers

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17 See www.brighton.com/retailers/index.html.

18 See U.S. Census Bureau: Texas Retail Trade, Summary Statistics for the State: 1997, Table 1, 12/9/1999 at www.census.gov/epcd/ec97/tx/TX000_44.HTM.

carrying the Brighton line would be especially unlikely to form a cartel because Leegin's channel focus is on small, independent retailers, not the nation's large chain retailers. To make the cartel effective, other retailers of fashion accessories that compete with Brighton products would have to be brought on board, further compounding the communication and coordination obstacles.

Second, in my own study of the record in this case, I encountered not even a hint that there is a retail cartel in place. In my field trips and review of trade literature, I find no suggestion that retailers are in cahoots in setting the retail prices on Brighton merchandise.

Third, as I understand the Complaint, the plaintiffs have not alleged a retailer cartel. I take that to mean that in their own experience, they have neither encountered nor gathered any evidence of a retailer cartel. Dr. Woods, in his report, also makes no mention of a retail cartel hypothesis.

VI. B. Manufacturer Cartels Using RPM

In a typical cartel, sellers collude on the price they charge their customers and do not endeavor to set the resale price of their product.[19] Nonetheless, a cartel of manufacturers might use RPM to help monitor and enforce the cartel's collusive behavior. In this economic model, manufacturers collude on the prices they charge their retailers. To make the cartel more effective, i.e. to reduce the incentives to cheat on the cartel price, each manufacturer in the cartel also has an RPM policy in place with retailers (at a price the manufacturers jointly determined).

In a traditional cartel, there is a strong incentive to cheat on the agreement by shading price and expanding output.

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[19] For example, I worked for plaintiffs on the recent international cartel in the vitamins industry. While participants in the vitamins cartel agreed upon the prices they charged, they did not try to influence prices *their customers* charged.

Incremental sales typically are very remunerative because the cartel has jacked up the price. But where a cartel of manufacturers has made RPM a part of the cartel arrangement, a manufacturer who cheats gains no additional sales. The cheating firm simply enriches its retailers (unless its retailers also lowered their prices, which might be observed by other cartel members as a violation of the manufacturer's RPM policy).

In other words, manufacturers agree to set a collusive price to *their* customers and, in addition, agree to maintain a common collusive price that downstream retail vendors are to charge *their* customers. If price cuts did take place at retail in response to a cartel cheater, this would alert the manufacturers that they have a cheater in their midst: the manufacturer who serves, or primarily serves, that particular retailer.[20]

Just as real world examples of retailer cartels that use RPM as a mechanism for collusion are not common, real world examples of manufacturer cartels that used RPM as a monitoring and enforcement device also are uncommon. Pauline Ippolito's study of RPM litigation finds less than 10% of private cases involve even the *allegation* of manufacturer or retailer collusion.[21]

There is no evidence of a horizontal agreement between Leegin and the hundreds of manufacturers that make handbags, jewelry, belts and other items that compete with the Brighton line. The impediments to a manufacturer cartel are substantial. One problem is the sheer number of manufactur-

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20 This type of cartel works best when the product is homogeneous. Any non-price competition among the putative cartel members would be difficult to detect if the products are differentiated.

21 Pauline M. Ippolito, "Resale Price Maintenance: Empirical Evidence from Litigation," *Journal of Law & Economics*, Vol. 34, October 1991, pp 263-294.

ers. Forming and policing a cartel in any market becomes more difficult as the number of firms increases. Data on the manufacturing base for this industry are not easy to come by. But Census data indicate that there were 137 women's handbag and purse manufacturing establishments alone (operated by 136 companies) in the United States in 1997.[22] The available data make clear that a manufacturer cartel in women's handbags and purses is implausible if not impossible.

A second obstacle to the formation of a manufacturer cartel is the ease of entry and high supply elasticity in the market. There are no key inputs that Leegin controls that would keep out new entrants if, hypothetically, a cartel were operative. In addition, if the cartel did not embrace all manufacturers, there would be a high supply elasticity among vendors who can manufacture competitive products. Some could even be suppliers of the hypothetical cartel, who would produce output for non-members as well. In addition to the sheer number of actual producers of women's fashion accessories, there are other manufacturers who could, with modest switching costs, begin producing these items if prices were to be set at supra-competitive levels. Thus, any cartel involving Leegin and other manufacturers that attempted to get underway would face competition from new entrants and existing firms.

My plant tour of Leegin's production facility illustrates this point. The production process is not capital-intensive and no large investments would be required to reproduce the facility. This is not an industry with high entry barriers. Indeed, the building Leegin occupies does not have assets that are specific for manufacturing only the Brighton line. It also could support the production of competitive products. This suggests that if other entrepreneurs wanted to enter the market and compete with Leegin (and its incumbent rivals), there

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22 U. S. Census Bureau: "Women's Handbag and Purse Manufacturing," Tables 3 and 4, 12/11/1999, pp. 8-9.

is no bottleneck on inputs that are controlled by Leegin and unavailable elsewhere. Likewise, if Leegin's current rivals wanted to expand their supply, there are no resource constraints that would prevent them from doing so.[23] Consequently, a cartel of manufacturers is unimaginable, not only because of the large number of firms, but because these firms do not market their output in the same way.

Third, there is no mention in the plaintiffs' Complaint of a manufacturer cartel (in which Leegin is a putative participant). Dr. Woods, in his report, also makes no mention of a manufacturer cartel hypothesis. Here again, the dog that does not bark comes to mind.

VI. C. RPM and the Marginal and Inframarginal Consumer

The main economic objection to RPM is when it is used as a device to enable or facilitate cartelization of markets.[24] A third concern economists have raised about RPM is whether it helps some consumers, harms others, and on net does more harm than good. I am unaware of this particular RPM theory having any influence in antitrust law.[25] The theory assumes two kinds of consumers who value a particular product: one (the so-called "marginal" consumer) is ill-

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23 While the skills and tenacity of Leegin employees I observed assembling some of the Brighton products are remarkable, nonetheless the skills could be taught to employees of other firms who either want to expand sales in this market or become a new entrant.

24 My understanding is that the use of RPM to organize and operate either a retail or a manufacturer cartel is unlawful under the antitrust laws.

25 The theory can be found in William B. Comanor, "Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy," *Harvard Law Review*, Vol. 98, March 1985, pp. 983-1002. See also Don Boudreaux and Robert B. Ekelund, Jr., "Inframarginal Consumers and the Per Se Legality of Vertical Restraints," *Hofstra Law Review*, Vol. 17, Fall 1988, pp. 137-158.

informed about a product but might purchase the product if its sale were accompanied by retail promotion and services that make him or her a knowledgeable consumer. To the extent a manufacturer's RPM policy induced and incented these services, "marginal" consumers become better off (i.e., enjoy more consumer surplus). The "inframarginal consumer" is satisfied with the product in "plain vanilla" form, or already is so informed about the product's characteristics that additional retail sales and service endeavors are unnecessary or of little value. The inframarginal consumer is happy to buy off-the-shelf at low prices.

Economic analysis can show that in the case of a market with lots of inframarginal consumers, and few marginal consumers, RPM can reduce overall economic welfare. On the other hand, economic analysis can show that in a market with few inframarginal consumers and many marginal consumers, RPM can increase overall economic welfare. To weigh the impact of RPM upon consumers becomes, under this theory, a matter of counting noses.

In the context of the antitrust case against Leegin, this theory does not fit the facts. Leegin's pricing policy is designed to induce and incent store-owners and sales personnel to promote the Brighton line, and to enable Leegin to compete with larger department stores offering more prominent brands. Leegin's pricing policy does not prevent other manufacturers from selling belts, handbags, and purses in "plain vanilla" fashion or at price points higher than Leegin's products. Consumers who want low-price and less fashionable merchandise have many brands and retail locations to choose from. For example, "everyday" low price purses can be purchased at Sears, K-Mart, Target, and Wal-Mart, as well as thousands of independent retailers and discount stores.

At the same time, those consumers who want women's accessories retailing at price points at or above the Brighton line are not deprived of these options because of Leegin's SRP policy. The brands of Louis Vuitton, Gucci, Prada and Francesco Biasia would come to mind for the fashion con-

scious. Consumers who want name brand fashion accessories sold seasonally at relatively high prices, then offered "on sale" at discount prices, have this option at department store chains and other retail outlets that "pulse" their prices.

The inframarginal-marginal consumer theory has other shortcomings when applied to this case. I have seen no evidence, from plaintiffs or from my own research, that consumers of women's fashion accessories fall neatly into two discrete bins: marginal and inframarginal. Some consumers may be well-informed with regard to belts but not with regard to eyewear. Moreover, some inframarginal consumers of, say, handbags, may have become that way earlier through knowledge gained at retail stores that provided them with pre-sale product information and post-sale services.

Presumably a manufacturer would only implement RPM if it pays off because more consumers are in the marginal category. The fact that Brighton's output has grown considerably while the SRP policy has been in place indicates strongly that consumers on net have benefitted.[26] One antitrust authority, who is now a federal appellate judge, considers this to be *the key indicator*. Richard Posner explains:

> "If [the defendant firm's] output expanded, the restriction must have made the firm's product more attractive on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition. The increase *must* exceed any net reduction in intrabrand competition considered in both its price and service aspects. Any reduction in

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26 For example, Brighton handbag sales grew from 125,609 units in 1996 to 375,480 in 2003. Brighton jewelry sales (includes home products) grew from 0 units in 1996 to 3.56 million units in 2003.

> intrabrand competition, viewed by itself, would increase the price to the consumer and hence make the product less attractive to him. If, on balance, the product is more attractive to consumers, as demonstrated by the fact that more of it is sold, the net effect of the restriction on competition must be positive."[27]

The plaintiffs do not raise the marginal vs. inframarginal theory in their Complaint against Leegin. Nor does Dr. Woods, in his report submitted on behalf of the plaintiffs. It is just as well. The theory does not apply to this case.

VII. RPM and Antitrust Injury: Rule of Reason versus *Per Se* Analysis

My understanding is that antitrust law applies to situations where there has been antitrust injury, meaning that a distortion in the competitive process has harmed consumers or, in economic terms, reduced consumer welfare. For some business practices, the harm to consumers is so transparent that courts consider the conduct to be *per se* illegal. Economic logic suggests that the *per se* category of antitrust offense should be for business conduct so unlikely to ever confer consumer benefits that a full-blown (or "rule of reason") inquiry into the practice is not worth the candle.

VII. A. Squaring Price and Non-Price Vertical Arrangements

As I teach my students, at one time a number of vertical practices were thought to be so unlikely to generate consumer benefits that they were considered *per se* violations of antitrust law. Exclusive territory and RPM agreements are examples. As courts discovered the pro-competitive benefits of exclusive territories, this marketing practice was moved to

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[27] Richard A. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," *University of Chicago Law Review* Vol. 48, Winter 1981, p. 21, emphasis in original.

the rule of reason bin. The decision by the Supreme Court that accomplished this move, *GTE-Sylvania*,[28] explicitly cited the economic concept of the free rider.

To the extent prevailing antitrust law governing non-price vertical arrangements is properly calibrated, this would suggest the rule plaintiffs propose regarding vertical arrangements on price is asymmetric with the economic logic of *GTE Sylvania, Inc.* In other words, if the *per se* rule is to thwart conduct that is always (or almost always) anticompetitive, then to apply the *per se* rule to all situations of RPM is to misapply the rule. Economic analysis reveals those circumstances when RPM can cause antitrust injury. But economic analysis also reveals the circumstances when price and non-price vertical practices can be procompetitive. Both price and non-price vertical practices have the potential to increase interbrand competition.[29]

To square the economics of RPM with that of other vertical arrangements, and maintain the obvious enforcement benefits of a *per se* rule, RPM would be *per se* illegal when it is associated with a horizontal combination. In the absence of any horizontal component, vertical arrangements on price would be viewed under the rule of reason.[30]

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[28] *Continental T.V., Inc. et al. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977).

[29] The enhancement of interbrand competition is not undermined by effects on price. Non-price vertical arrangements, such as exclusive territory agreements, have a price effect.

[30] A rule of reason inquiry need not be an expensive and time-consuming task for the court if the manufacturer using RPM does not possess market power of antitrust concern (i.e., where there is abundant interbrand competition). Any firm that does not have a large market share, is not protected by high barriers to entry, or faces a high supply elasticity from other rivals, does not have significant market power. Such a firm, not in cahoots with its rivals, cannot use RPM to cause antitrust injury. As explained earlier, interbrand competition would discipline

[Footnote continued on next page]

Leegin's SRP pricing practice is at the opposite end of the spectrum from what a *per se* rule is intended to cure. Leegin's strategy to protect retail margins in order to incent retail services merits a rule of reason inquiry. In fact, I know of no economist who presently endorses a *per se* approach to either vertical price or non-price marketing practices that are unilateral and implemented by firms without market power of any antitrust concern. The business model of Leegin, with regard to SRP, clearly does not fit in antitrust's *per se* bin.

VII. B. RPM and the Meaning of "Agreement"

The decision by the Supreme Court recognizing a manufacturer's right to implement RPM unilaterally is *Colgate*.[31] The *Colgate* doctrine, as I understand it, affords a manufacturer the option to announce a take-it-or-leave-it policy of selling only to downstream vendors who price at the manufacturer's SRP. *Colgate* allows a manufacturer to enforce its RPM policy by refusing to do business with retailers who shade or cut the SRP.

The plaintiffs contend, as I understand their Complaint, that because many retailers adhere to Leegin's SRP, this shows there must be an "agreement" between Leegin and these stores.[32] Dr. Woods, in his report, echoes this line of reasoning, concluding that if there were no agreement, all retailers would behave like Kay's and cut prices.[33] Both the plaintiffs and Dr. Woods are mistaken in their analysis.

[Footnote continued from previous page]

such a firm if its RPM strategy did not enhance consumer welfare. Indeed, a firm without market power that uses RPM does so in the hope that it will make the firm a more vigorous interbrand competitor.

31 *U.S. v. Colgate & Company*, 250 U.S. 300 (1919).

32 Complaint ¶¶ 17-18.

33 Woods Report, p. 5.

The fact that a group of firms behaves the same way does not mean they have collectively decided (or "agreed among themselves") to behave that way. This is not only true as a matter of economic theory,[34] it is a basic principle of antitrust analysis.[35] In like fashion, the fact that a group of retailers willingly abide by Leegin's SRP policy does not imply any cartel agreement on their part nor agreements between them and Leegin. Each retailer, facing Leegin's take-it-or-leave it pricing policy, has the option of electing to follow Leegin's business model, or not distribute Brighton products. A retailer who chooses to adopt the SRP policy recognizes that adhering to Leegin's SRP generates benefits for the retailer because it can provide the marketing services Leegin wants Brighton's customers to enjoy. In the process, the retailer can still make a competitive rate-of-return.

Thousands of retailers have decided *not* to stock the Brighton line and therefore have decided not to abide by Leegin's SRP policy. Based simply on actions and behavior, these retailers have no more "agreed" among themselves not to engage in RPM with Leegin than the hundreds of retailers who independently elect to follow Leegin's SRP policy have "agreed" to participate in Leegin's SRP program. If a particular retailer elects not to distribute Brighton products, presumably that is the optimal course of conduct for that firm. If another retailer elects to distribute Brighton products under

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34 In the economist's model of perfect competition, sellers all charge the same price. But in the theory of perfect competition, there is no cooperative behavior among the many sellers. In oligopoly markets, the fact that one firm follows the price lead of another does not mean that the two firms have "agreed" on a price. Indeed, absent agreement, a first mover on price cannot prevent a second or third mover from unilaterally following its lead. Parallel behavior, in other words, is not necessarily collective behavior.

35 See Philip E. Areeda and Herbert Hovenkamp, *Antitrust Law*, 2nd edition, 2003, Vol. VI, pp. 59-66 and following.

the SRP, presumably that is the optimal course of conduct for that firm. In either case, the choice remains with the retailer and, in the context of this market, the consumer is not harmed by the unilateral choices of these retailers, whichever is their choice. In short, based on economic analysis, there is nothing about the conduct of Leegin or its retailers that excludes the possibility of unilateral behavior.

The particular phraseology involved in the documents that set forth Leegin's SRP policy impact neither the retailers' incentives nor Leegin's.[36] The key elements required for the policy to have its procompetitive effects are that it be enforced (i.e., discounters are no longer supplied by Leegin) and that prospective retailers of Brighton products are aware that Leegin's SRP policy will be enforced. In this environment, retailers' choices are independently made in response to these terms and the *Colgate* standard is met.

Leegin has independent (or unilateral) incentives to operate in accord with the *Colgate* doctrine and economic analysis offers an explanation why this business model makes sense for this firm. Leegin is a small player in a competitive industry marked by high supply elasticity and low entry barriers. Leegin sells a product that it seeks to differentiate from its rivals and faced with a classic free rider problem it makes use of the *Colgate* doctrine to implement and enforce its SRP policy. If there is any prospect of consumer

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[36] Leegin's SRP policy was implemented in April 1997 when letters describing the policy were sent to retailers. The Brighton Heart Store program began later, *circa* January 1998, and the description of this program reiterated the existing SRP policy. Nothing about the original statement of the SRP policy or its restatement in the literature describing the Heart Store program indicate any difference in what Leegin hoped to accomplish: to deter free riding and incent retailers to promote the Brighton product line. (See "Declaration of Jerry Kohl in Support of Leegin's Opposition to Plaintiffs' Motion for Partial Summary Judgment," 11/25/2003, ¶¶ 15, 23, and 25.)

harm or antitrust injury from Leegin's use of RPM, I have been unable to uncover it. Nor are there marketing options available to Leegin that are more commendable from the standpoint of antitrust economics.

VII. C. Leegin's Options

One option available to Leegin is simply to state the SRP policy and then make no effort to enforce it. Clearly, this is equivalent to having no SRP policy at all and neither Leegin nor consumers of Brighton products would receive any of the benefits from RPM that I have described. In the event of a deviation from the SRP policy (i.e., discounting by a retailer), Leegin must protect the integrity of its pricing strategy by terminating its relationship with the offender.[37] If Leegin continued to supply discounting free-riders, adherence to the SRP policy could erode and ultimately Leegin's business model would be undermined. Since Leegin's pricing policy results in the efficient distribution of its product line, and enhances rather than restricts demand, laxness on the part of Leegin would result in harm to consumers.

As a second option, Leegin might have used vertical arrangements other than its SRP policy to induce downstream marketing service and avoid the free-rider problem. However, in the market for women's fashion accessories, non-price vertical arrangements have shortcomings (for Leegin and for consumers) that an SRP practice does not have. For example, exclusive territories can make economic sense if the items sold are big-ticket items and if consumers have

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37 According to Mr. Jerry Kohl, Leegin rarely needs to exercise this option. (See "Declaration of Jerry Kohl in Support of Leegin's Opposition to Plaintiffs' Motion for Partial Summary Judgment," 11/25/2003, ¶ 22.) The fact that Leegin seldom must cut off retailers for violating the SRP policy is not proof of an agreement between Leegin and its retailers. Rather, it is evidence that the policy is effective: each participating retailer understands it is in that firm's interest to follow Leegin's SRP policy.

high transaction costs of visiting alternative retailers. In women's apparel, however, many items are not high price and retailers do not try to "cultivate" a particular geographic territory that becomes its exclusive customer base. Most consumers of fashion accessories are too mobile for such a marketing strategy to be effective because shoppers often have a number of retail outlets nearby. In fact, Leegin and consumers both can benefit from having a denser distribution of Brighton products than exclusive territories would allow.

As a third option, Leegin could become fully vertically integrated: from manufacturer to retailing. This would eliminate SRP as a pricing policy. However, this business model would draw Leegin away from its core competency (creating and manufacturing women's fashion accessories); it would require Leegin to have additional financial capital; and it would likely result in a less dense distribution of Brighton products than the SRP practice currently generates. Moreover, the numerous small, independent retailers that now carry the Brighton line might be eliminated (or shrink in number).

It would be an odd application of the antitrust laws if Leegin were required to eschew independent centers of initiative in the marketplace and become fully integrated vertically in order to comply with the plaintiffs' view of the Sherman Act. Indeed, having a set of thriving, independent retailers that carry Brighton *and non-Brighton* products is an indicator of the competitive diversity in women's fashions.

Based on my study of the Leegin business model, and the firm's use of SRP with regard to its Brighton line, I am persuaded that the business practices the plaintiffs complain about are pro-consumer and enhance competition for the consumer's dollar. Leegin's business model does not enable Leegin to have, as the Complaint in this case alleges, "vertical pricing control to monopolize the market."

VII. D. The Plaintiffs' Expert Report

As mentioned earlier, on December 5, 2003 plaintiffs filed a report by Dr. James D. Woods, the head of the foren-

sic accounting and investigative practices unit at the consulting firm of Grant Thornton. Normally my report would contain a detailed analysis of the plaintiffs' expert report. But Dr. Woods' report contains no economic analysis of the markets involved in this litigation, either at the manufacturing or the retailing level. That is, one does not find in his report any study of the market's structure or conduct. Based on the data in Dr. Woods' report, one would not know if Brighton was the only brand of handbags available to consumers in the market, or whether Brighton was one of thousands of handbag brands, or whether it made a difference to his analysis one way or the other.

In addition, Dr. Woods' report contains no explicit discussion of the economic theory of RPM. For example, Dr. Woods never mentions the free rider -- even though the free rider normally would be a part of any economist's analysis of RPM. Evaluating Leegin's business model without any discussion of the economic concept of the free-rider is like evaluating the career of Thomas Edison but not mentioning the light bulb or studying the career of George Eastman but overlooking the camera.

Moreover, Dr. Woods never connects his report to the plaintiffs' Complaint. The Complaint alleges that Leegin has engaged in "vertical pricing control to monopolize the market." It is standard procedure in antitrust cases, where monopolization is charged, to define the relevant market(s) in which the alleged monopolization is purported to take place. The Complaint asserts "anticompetitive effect in the market for the Brighton line." (Complaint ¶ 17) But surely the Brighton product line is not a relevant market for antitrust purposes. If it were, then each and every firm that sells a branded product has a monopoly over the "market" for its "line." The "market for the Brighton line" is not a relevant market by any standards of market delineation of which I am aware.

Dr. Woods does not remedy the Complaint's deficiency of not defining a relevant market. Nowhere does he define a

relevant market, explain what market he analyzed, or purport to show that any relevant market has been monopolized or faces even a remote prospect of being monopolized. Of course, this omission in Dr. Woods' report is understandable. There are no data to support the Complaint's allegation of a "market for the Brighton line" and no evidence showing Leegin to have monopolized *any market, anywhere, any time.*

For example, consider just handbags. In my visit to The New Mart and the California Market Center, I observed dozens of vendors of women's handbags alone who use these locations to market their merchandise to retailers.[38] The New Mart directory lists 46 vendors of handbags, from Anja Flint to Viva Bags. The California Market Center has 112 vendors of handbags, from Alok Goel to Yancha. The day I toured the Center, the lobby alone had eleven companies displaying their lines of women's handbags. Many of the vendors offer dozens of models and styles of handbags. To claim, as Plaintiffs do, that Leegin's SRP policy "penalize[s] . . . consumers" and gives Leegin "vertical pricing control to monopolize the market" would sound bizarre to anyone who saw the enormous array of women's accessories being marketed just at these two locations.

If that were not enough, if one walks from The New Mart or California Market Center buildings a couple blocks (to the intersection of Santee Street and Olympic Boulevard and the environs), one enters a neighborhood of dozens of firms that sell clothing and women's accessories, at both retail and wholesale. Handbags, belts, jewelry, and luggage to stock a retail outlet are in abundant supply. And if that were not enough, I am told that much the same phenomenon exists in Dallas, Atlanta, and in New York. All this shows that if

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[38] Essentially, these are wholesale markets that bring together manufacturers and retailers. Consumers of clothing and accessories generally are not eligible to shop these premises. The exception, as I understand it, is on days when samples are being sold.

Kay's cannot handle the Brighton brand, there is no shortage of substitutes and alternatives available in the marketplace. One would, however, have no knowledge of this based on a reading of Dr. Woods' report or from the plaintiffs' Complaint.

Dr. Woods singles out the inventory requirements applicable to Brighton Heart Stores in his report. (See Woods Report, pp. 3-4) But there is no antitrust injury associated with Leegin's inventory policies. Economic analysis recognizes that RPM can help both manufacturers and retailers optimize inventory holdings in a fashion that ultimately benefits consumers.[39] By maintaining a minimum resale price, retailers are protected from the prospect of losses from price wars. In response, retailers maintain adequate in-store quantities of the product to satisfy consumers during times of high demand. In situations when demand for the Brighton line is high, consumers avoid the disappointment of understocked stores and can purchase the product when they wish.[40] As with the other effects of Leegin's business practices, the use

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[39] The standard academic reference is Raymond Deneckere, Howard P. Marvel, and James Peck, "Demand Uncertainty, Inventories, and Resale Price Maintenance," *Quarterly Journal of Economics*, Vol. 111, August 1996, pp. 885-913. Dr. Woods notes that Leegin would permit retailers to reduce the price of poorly performing Brighton products and laments that Leegin forbad advertising of such markdowns. In fact, this "escape hatch" allows retailers to recoup some of their losses when demand is low yet preserve the value of the Brighton brand to consumers.

[40] Consistent with the policy, however, retailers were permitted to place discontinued or poorly selling Brighton products on sale to make room for new products in the Brighton line. This practice is part of Leegin's strategy of ". . . assist[ing] retailers in determining which products were selling and making decisions about inventory." See "Declaration of Jerry Kohl in Support of Leegin's Opposition to Plaintiffs' Motion for Partial Summary Judgment," 11/25/2003, ¶ 5.

of RPM to facilitate sufficient inventory holdings benefits consumers.[41]

Dr. Woods also belittles the concerns expressed by Leegin with regards to its reputation for consistent pricing.[42] Here too, he fails to recognize the simple economic reasoning behind this aspect of the policy: that by maintaining one price for each product, Leegin relieves consumers of the search costs of learning if a particular retailer's offered price is too high. The policy also alleviates any concern that a mark-down is imminent and consumers will be left (no pun intended) 'holding the bag.' One need only think of the stress some shoppers encounter in certain transactions (e.g., buying an automobile) to understand the value to the consumer of such a guarantee. Everyday pricing distinguishes Brighton from pulse pricing used by many department stores.

Finally, Dr. Woods never explains how the effect of Leegin's price policy is to "penalize the consumers of goods" — unless all he means is that if Kay's offered a Brighton purse at $179.99, instead of charging the Brighton SRP of $200.00, consumers must be better off. But this is not sound

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41 Dr. Woods also cites several non-RPM incentives that Leegin offers Heart Store retailers as part of the inducement to maintain adequate inventories, including "better credit terms, financial assistant [sic] acquiring fixtures to sell Brighton products, advertising assistance and additional attention from Leegin's [staff]." See Woods Report, p. 4. However, these non-price arrangements are not in conflict with any antitrust policy of which I am aware. They certainly do not lessen competition.

42 "Leegin also wanted its customers to be free from the concern that they might be 'taken' by paying excessive prices for Brighton products, that the same product might soon be put 'on sale' or offered for a lower price in the same store or other stores, or that they needed to 'haggle' to get the best price." See "Defendant Leegin Creative Leather Products, Inc.'s Initial Disclosures," 9/24/2003, p. 2. Judging from Leegin's growth, many consumers like this type of shopping experience. There is nothing in antitrust analysis that should deny them this option.

economics, even in this contrived example. In Dr. Woods' simplistic analysis, he misses the difference between competition on price *and* service and never grapples with what the world would look like, for Leegin and consumers, if Leegin could not induce retailers to promote the Brighton product line by an SRP policy.

Antitrust law applies in those situations where there has been antitrust injury. This means anticompetitive conduct took place and/or consumer welfare was reduced. Since the logic of a *per se* rule is its application to RPM only where antitrust injury is transparent, it should not be applied in a wooden and mechanical fashion to all vertical price arrangements because most of these are benign. In the case of Leegin, consumers of women's fashion accessories have not been harmed and the competitive vigor of the market has been enhanced by Leegin's entry and growth. Consequently, no antitrust injury was sustained.[43]

VIII. Conclusion

As I understand antitrust law, a manufacturer with a resale price maintenance policy in compliance with the *Colgate*

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[43] I am informed that plaintiffs' damages expert, Mr. James Davis, has estimated damages based on profits allegedly foregone by the plaintiffs once they were no longer Brighton retailers. This strikes me as the wrong calculation. If the court were to conclude that Leegin had entered into an unlawful agreement with retailers, the relevant "but for" world for calculating damages is one where Leegin, under the *Colgate* doctrine, unilaterally refuses to sell to price-cutters. The implication is worth restating since the plaintiffs have gone off track here. Modern antitrust economics puts its chips on harm to consumers. If Leegin's conduct is permissible under *Colgate*, than it follows that an SRP policy instituted "by agreement" does nothing more to harm consumers. As I show in the body of this report, Leegin's SRP policy (whether tagged unilateral or collusive) promotes and does not reduce competition. Also, it is clear that plaintiffs could have mitigated their alleged damages by substituting other merchandise for Brighton products.

doctrine has not violated the Sherman Act because its unilateral conduct means there is no "agreement" between it and downstream retailers. The economic conduct of both Leegin and its retailers is consistent with unilateral behavior (as I demonstrate in my report).

If an "agreement" were found between Leegin and its downstream retailers regarding SRP, a rule of reason analysis is appropriate in this case to make symmetrical the treatment of price and non-price vertical agreements. A *per se* approach is not fitting here because there is no evidence that Leegin's conduct falls within the set of practices that transparently reduce consumer welfare (again, as I demonstrate in my report).

Leegin's business model fits so poorly in the *per se* bin in part because Leegin itself is such an odd candidate for a charge of "vertical pricing control to monopolize the market" and implementing a business practice that "reduces competition." Leegin is a small firm in a market populated with many firms, at both the manufacturing and retailing levels. It has implemented an SRP pricing practice to gain a foothold in this industry. Consumers have been the beneficiaries as have independent retailers who have a brand that is "theirs" and not commonly shared with large, chain retailers.[44] Leegin's SRP policy is not part of a cartel among manufacturers of women's fashion accessories nor part of a cartel among retailers.

With no remotely plausible (or even alleged) horizontal conspiracy in this case, an application of a *per se* rule on SRP would condemn a marketing strategy that increases competition. A far more consumer-friendly rule would be that, in the absence of any horizontal component, vertical arrangements on price would be permissible or, alternatively, be viewed under the rule of reason.

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44 The only exception of which I am aware is Nordstrom's.

Leegin got its start, in part, by offering small independent retailers and chains the prospect that they could make a margin on Brighton products that would compensate them for the time and effort they needed to put into selling the brand. Any retailer who provided the brand-building services to customers (necessary for Leegin to prevail in *inter-brand* competition) could make these investments so long as it was clear that Leegin's SRP policy would be enforced against it and against other retailers. The policy would then mean that retailers would not be undercut by free riders.

As I indicated in Section IV of this report, the focus of my analysis in this litigation is consumer welfare. When the goals of antitrust are discussed, the efficient promotion of consumer welfare generally is recognized as the primary goal.[45] The SRP business model Leegin uses in marketing its Brighton line is pro-competition and pro-consumer. Consequently, if the plaintiffs were to prevail in this case, consumers would be made worse off.

Moreover, the RPM policy of Leegin is designed to help the independent retailer survive and compete. Mr. Jerry Kohl's philosophy, from the early days of starting the Leegin firm as a small manufacturer, was to develop a business model that would enable small retailers to compete against

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[45] Some would argue the only goal. See Robert Bork, *The Antitrust Paradox*. Basic Books, 1978, p. 89. See also Kenneth G. Elzinga, "The Goals of Antitrust: Other Than Competition and Efficiency, What Else Counts?" *University of Pennsylvania Law Review*, Vol. 125, June 1977, pp. 1191-1213; Philip E. Areeda and Herbert Hovenkamp, "Today it seems clear that the general goal of the antitrust laws is to promote 'competition' as the economist understands that term. Thus we say that the principal objective of antitrust policy is to maximize consumer welfare by encouraging firms to behave competitively, while yet permitting them to take advantage of every available economy that comes from internal or jointly created production efficiencies, or from innovation producing new processes or new or improved products." *Antitrust Law*. Vol. 1, p. 4 (2000).

large chain retailers. For this accomplishment, Mr. Kohl is an honored entrepreneur who has expanded the commercial horizons of dozens and dozens of small retailers. What plaintiffs have managed to do here is bring a lawsuit that not only is harmful to competition, at the same time it is harmful to small business.[46]

What plaintiffs seek to accomplish is the antitrust equivalent of hockey's hat trick except each of the three goals is a perverse one: (1) plaintiffs seek to free ride off the investment of Leegin and other retailers of the Brighton brand; (2) plaintiffs seek to diminish the ability of Leegin to gain retail promotion and brand certification; (3) plaintiffs seek to be awarded damages and injunctive relief without showing any antitrust injury. It would turn antitrust on its head to find that Leegin has, to quote the plaintiffs' Complaint, used "vertical pricing control to monopolize the market" and to "penalize the consumers of goods" when in fact Leegin has used a pro-competitive pricing practice that has aided the economic viability of hundreds of independent retail businesses in the United States.

Respectfully,

/s/

Kenneth G. Elzinga

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[46] One illustration of the internal conflict within the Complaint is that the conduct plaintiffs condemn would be perfectly lawful if Leegin quit dealing with small independent retailers and instead was fully integrated vertically and owned all its retail outlets. Then, Leegin would be free to "set retail prices" at whatever level the company chose without any prospect of antitrust attack. Such a move would, of course, not improve consumer welfare or economic efficiency.

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No. 06-480

FILED
NOV 3 - 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

LELGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC. D/B/A KAY'S KLOSET...KAY'S SHOES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

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COUNTERSTATEMENT OF QUESTION PRESENTED

In view of (1) Defendant's participation as a full member in a horizontal price fixing scheme; (2) an unbroken line of cases extending back to *Dr. Miles*, in which this Court has held that written contracts between a manufacturer and a retailer fixing the resale price of a product are illegal *per se* under Section 1 of the Sherman Act; (3) this Court's earlier recognition of Congressional action demonstrating its intent that resale price fixing be treated as illegal *per se*; and (4) Congress's continued refusal to change the *per se* rule for resale price fixing, is it appropriate for this Court even to reconsider the long standing *per se* rule against vertical minimum price fixing?

RULE 29.6 STATEMENT

Pursuant to this Court's Rule 29.6, undersigned counsel states that PSKS, Inc., is a family owned corporation. No publicly held company owns 10% or more of its stock.

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IN THE

Supreme Court of the United States

No. 06-480

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC. D/B/A KAY'S KLOSET...KAY'S SHOES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

SUMMARY OF REASONS TO DENY THE PETITION

Cartels among participants at a single market level are universally condemned in American law. Such cartels are illegal *per se*, and no one argues they should not be.

In this case, Leegin Creative Leather Products, Inc., ("Leegin") both manufactures retail goods and participates in the retail market for goods, owning and operating its own retail stores featuring its Brighton brand products. Because of Leegin's active participation as a retail competitor of the plaintiff, PSKS, Inc., d.b.a., Kay's Kloset * * * Kay's Shoes ("Kay's Kloset") and other retailers, Leegin simply could not legally contract with retailers (Leegin's competitors) to fix the price at which they sold Brighton brand goods. Leegin's

actions run afoul of the long-standing rule against vertical minimum price fixing, and they violate the unquestioned *per se* rule against cartels.

For almost 100 years, since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), vertical agreements between a manufacturer and a retailer fixing the retail minimum price of consumer goods have been illegal *per se* under the Sherman Act. *Id.* at 404. On several occasions, this Court has reconsidered but always reaffirmed the use of the *per se* rule against vertical minimum price fixing. In doing so, the Court has recognized that Congress plays a primary role in establishing the applicable antitrust policy regarding resale price maintenance. In approving, and later repealing the "Fair Trade Laws,"[1] Congress demonstrated repeatedly its intent that the very actions Leegin undertook here are to be judged illegal *per se*.

Leegin's petition presents none of the traditional reasons for granting a writ. There are no conflicting circuit court decisions on this topic. Instead, there is complete consensus among the circuits, all consistent with the Fifth Circuit's decision in this case. More importantly, there is no conflict with any decision of this Court. The decision below indisputably correctly applied this Court's well settled precedent. Thus, the petition fails to provide any adequate reason for granting the writ. Sup. Ct. R. 10.

STATEMENT OF THE CASE

1. Notwithstanding that vertical minimum price fixing agreements have been illegal *per se* since 1911, Leegin em-

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[1] Congress created express exceptions to the Sherman Act that permitted States to enact laws permitting certain manufacturers to establish minimum retail prices for certain goods. As discussed *infra*, those state "fair trade" laws were ended in 1975 when Congress repealed the exceptions to the Sherman Act that enabled those state laws.

barked on a plan to enter written agreements with its key retailers fixing the resale price of Brighton goods. In 1998, Leegin induced those retailers to sign and return a "Brighton Pledge" form that provided:

> I understand the duties, philosophies, and responsibilities of being a Brighton Heart Store and agree to abide by them. As a Brighton Heart Retailer I pledge to * * * Follow the Brighton Suggested Pricing Policy at all times.

(4 R. 972). In the years that followed, Leegin solicited agreements from retailers, and retailers executed and returned "Brighton Heart Store Agreements" providing that retailers "agree to * * * Sell Brighton products for the suggested price every day, 365 days a year." (4 R. 984). Leegin continued the Heart Store program through the time of trial, requiring "Heart Store" retailers to sign and return a new agreement each year.

Leegin, through its owner, also owned a number of retail outlets that exclusively featured the Brighton line of products. In addition, it licensed a number of other retail stores the right to use the Brighton name as a part of their store name. Leegin requires both its own stores and the independent "Brighton" stores to execute Trademark License agreements. Those agreements bind the licensee to undertake certain obligations and Section 3b states, in part:

> Licensee shall comply fully with all obligations which arise as a customer of Licensor with respect to its purchases of goods, including without limitation Licensor's "Brighton Retail Pricing and Promotional Policy" as in effect and as updated from time to time.

(P. Ex. 114).[2]

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[2] In addition, Leegin required retailers that wished to sell Leegin's luggage to execute a separate "Luggage Agreement" that obligated the retailers to offer that luggage "at the suggested retail price."

Leegin enforced the price fixing agreements against all of its retailers. Jerry Kohl, Leegin's president and owner, testified: "[W]e require every one of our customers, whether they are a Heart Store or a Brighton Collectibles store or a store, as you classify, independent retailers, we require everybody to charge the same price." (5 R. 75-76). Leegin's enforcement efforts took the form of threats to stop shipment, suspensions of shipment pending agreement to raise prices, or, as in Kay's Kloset's case, complete cessation of shipments. (5 R. 83, 6 R. 45-46, 50, 54-56).

Contrary to Leegin's claim, Kay's Kloset established that this series of contracts—and not some "policy"—constituted illegal price fixing that violated the clear and consistent holdings of this Court and that such contracts are illegal *per se*. This case presents a situation in which Leegin made a conscious and determined choice to enter price fixing contracts with retailers across the nation, and to enforce those agreements. Leegin chose this course of conduct despite the clear law that such conduct is illegal *per se*.

2. Not only does Leegin manufacture and sell its merchandise to independent retailers, it owns and operates its largest stores. At the time of the case, Leegin shared common ownership with Brighton Retail, a company that owned fifty Brighton only retail stores, and with Corazon, a company that owned twenty-one retail stores in four states. (5 R. 52, 55). Those seventy-plus stores, along with the Heart Stores, accounted for a substantial share of Leegin's total sales. (5 R. 60, 123). Several of Leegin's stores were in the Dallas, Texas area, and at least one of them competed directly with Kay's Kloset. (10 R. 11).

By operating its own retail outlets in the best locations (i.e., those locations that can support a stand-alone store exclusively dedicated to Brighton products), Brighton became its own best customer at the retail level. Under these circumstances, Brighton's price fixing agreements effectively

constitute a horizontal retailer cartel. Brighton could set the prices above market, and avoid intrabrand competition by securing price-fixing agreements with the largest independently owned stores (e.g., "Heart Store Agreements"). Indeed, there was ample evidence that Leegin was directing a collusive, horizontal scheme to fix prices at the retail level.

The record below shows that Leegin paid for trips for representatives of its largest retailers to meet in Hawaii. Anne Wolfe, one of those retailers, testified about those meetings. In a session led by Leegin, she described a discussion about pricing practices among Brighton dealers. Those present at the session reached a consensus about Leegin's pricing practices. That cartel agreement was then approved by Jerry Kohl, who owned Leegin and its Brighton Stores. (9 R. 119-24). In an e-mail, Jerry Kohl stated: "What we have decided is OK after talking to more than 100 retailers is a birthday Club that on your birthday (or within a short time of your birthday) a consumer can get a discount on 1 piece of merchandise in your store (everything not only Brighton)." (P. Ex. 73). Leegin implemented the agreement in its own stores, and enforced it against all other stores.

Other evidence showed Leegin acting as a hub in a classic spoke-and-hub horizontal price fixing conspiracy, by serving as a middle man to make agreements between competing stores that wanted to engage in price competition. Leegin's sales representative disclosed how Leegin management would "try and work up some agreement from the middle man. I mean, maybe this will blow up and Ann will—they'll discuss it with [retailer] Ann. They'll discuss it with the [retail store at the] airport, you know, make everybody play by the rules." (7 R. 95).

Leegin undertook to suppress competition among retailers in other ways. Jerry Kohl referred repeatedly to this theme in e-mails. For example, he noted that if gift-with-purchase giveaways were permitted, "the other retailers in the area feel

they have to compete and before long its [sic] chaos." (P. Ex. 74). Laura Young, Leegin's second-in-command and the person in charge of the Brighton line, declared that discounting activities would "spread like cancer," (P. Ex. 67) and that retailer competition would result in a situation that is "out of control." (P. Ex. 74).

As a retailer, Leegin had every incentive to undermine competition in the pricing of Brighton products. The manager of Leegin's retail stores testified that fixed minimum price improved Leegin's profitability and helped Leegin's retail stores "be profitable for a long period of time." (9 R. 64-65).

3. Kay's Kloset is a women's specialty store that operated in Lewisville, Texas.[3] Since it opened in 1986, it has been engaged in the retail sale of fashions and accessories. In 1995, Kay's Kloset began offering the Brighton line of products. (7 R. 60). At its own expense, Kay's Kloset advertised and promoted the Brighton brand, spending tens of thousands of dollars on television, newspaper and direct mail ads. (7 R. 61-62). As a result, Kay's Kloset became *the* place to purchase Brighton in its market area. (7 R. 63).

In December 2002, Leegin ceased supplying Brighton products to Kay's Kloset, solely because Kay's was selling Brighton products up to 20% below Leegin's fixed retail price. The *only* reason Leegin ever gave for the termination was that Kay's Kloset was selling Brighton below Leegin's fixed price. (6 R. 50). As a result of Leegin's actions, Kay's Kloset lost substantial profits it would have earned selling Brighton products, which Kay's Kloset had advertised at great expense.

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[3] Since the date of the trial, it has moved approximately two miles to the neighboring town of Flower Mound.

REASONS FOR NOT GRANTING THE PETITION

I. LEEGIN'S RETAIL PRICE FIXING VIOLATED PROHIBITIONS AGAINST HORIZONTAL CARTELS

This case does not present an appropriate vehicle for this Court to revisit *Dr. Miles.* In *Dr. Miles,* the manufacturer defendant was not also an active participant in the retail market implementing a horizontal cartel. No one questions the pernicious effect of retail competitors conspiring to fix prices. That conduct is the archetypal example of actions that are presumed illegal without further examination. *Catalono, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 646-47 (1980). Even Leegin concedes that such horizontal agreements among retailers are anticompetitive. *See* Petition, p. 16.

Contracts between competitors are not saved from the *per se* rule of illegality because one of the competitors distributes to the others. In *United States v. McKesson & Robbins*, 351 U.S. 312 (1955), the Court analyzed a dual-distribution system. In that case, a manufacturer who distributed directly to retailers, as well as to wholesalers, entered into agreements with both retailers and other wholesalers to fix the resale price of its goods. Although the agreements with retailers were saved by the provisions of the Miller-Tydings and McGuire Acts then in effect, the agreements with other wholesalers were illegal *per se*. The Court noted that those acts "expressly continue[d] the prohibitions of the Sherman Act against 'horizontal' price fixing by those in competition with each other at the same functional level." *Id.* at 313 (quoting *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 389 (1951)). Because the defendant in *McKesson* participated in the wholesale market, its contracts with other wholesalers violated the "*per se* rule of illegality [for] resale price maintenance contracts between firms competing on the same functional level." *Id.* at 315.

Leegin cannot have it both ways. It cannot maintain that vertical price fixing arrangements are benign, while horizontal arrangements are not, and yet maintain that it can fix prices among retailers while at the same time participating in a significant economic manner in the retail market. Such an arrangement violates traditional prohibitions against price fixing among competitors.

The power of Leegin "to fix the price of the product that it manufactures, and which the entire group sells and with respect to which all have been and are now actual or potential competitors, is a powerful inducement to abandon competition." *United States v. Masonite Corp.*, 316 U.S. 265, 281 (1942). Price fixing among competitors of a single brand falls within the long-standing prohibition against horizontal cartels. *See United States v. Sealy*, 388 U.S. 350, 356 n.3 (1967). It does not matter whether the prices or pricing practices were discussed and voted on by the entire group: "The fixing of prices by one member of a group pursuant to express delegation, acquiescence, or understanding is just as illegal as the fixing of prices by direct, joint action." *Masonite Corp.*, 316 U.S. at 276. The negative impact on consumers—who pay higher prices—is the same, no matter how a cartel is achieved.

Thus, this case implicates the long-standing prohibitions on both vertical price fixing and horizontal cartels. Permitting Leegin to fix retail prices to benefit its own combined wholesale/retail operation violates the Sherman Act's fundamental prohibition against cartels.

The record below contains compelling evidence of a horizontal cartel designed and intended to benefit Leegin's retail operations. As a result, even were Leegin's conduct not prohibited by the *per re* rule against vertical price fixing, it is a *per se* violation of the Sherman Act's bedrock prohibition on horizontal cartels.

II. THE RULES REGARDING VERTICAL MINIMUM PRICE FIXING ARE WELL ESTABLISHED AND ABSOLUTELY CLEAR.

In *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court held that a manufacturer's contract fixing the retail price of goods constitutes a violation of the Sherman Act. The Court recognized that the suppression of competition among dealers by the manufacturer has the same practical effect as an agreement among the dealers themselves to suppress competition. Such agreements among dealers, however "are injurious to the public interest and void." *Id.* at 384-85. The Court applied the same rule to resale price fixing, holding that once the manufacturer sells its product to a retailer at a price satisfactory to it, "the public is entitled to whatever advantage may be derived from competition in the subsequent traffic." *Id.*

The Court has recognized that the *Dr. Miles* rule is limited to those situations involving contracts. In *United States v. Colgate & Co.*, 250 U.S. 300 (1919), the Court recognized that a manufacturer enjoys the freedom to choose who to deal with, and that he may "announce in advance the circumstances under which he will refuse to sell." *Id.* at 307. The *Colgate* doctrine has provided a vehicle for manufacturers to lawfully exercise some control over resale prices.

The decisions in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984) and *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988) have further defined both the limits of *Dr. Miles* and the *Colgate* doctrine. *Monsanto* established strict requirements on what conduct could constitute a contract, as opposed to mere acquiescence to a stated condition. *Sharp* required that there be an agreement as to price with remaining dealers to fall within the *Dr. Miles* rule. These cases have established an extremely high threshold that a party challenging vertical price fixing conduct must overcome to establish liability. As a result, only

rarely have companies been found to have engaged in prohibited vertical price fixing. It is the most unusual case, such as the present one, where the proof of illegal conduct—such as the written contracts entered by Leegin and its retailers—satisfies the Court's high standards and results in a *per se* violation.

The continuing vitality of the doctrine established by *United States v. Colgate & Co.*, 250 U.S. at 300, as well as the rule of reason standard for non-price vertical restrictions, have extended a great deal of freedom to companies to lawfully arrange their businesses to achieve permissible economies, while obeying the Sherman Act's clear limits on price fixing. The lack of cases challenging the established rules and the absence of any Congressional action to change the *per se* rule demonstrate that this is a highly unusual case and does not raise an issue of everyday importance.

At the federal level, there have been extraordinarily few challenges to resale price maintenance arrangements in the last twenty-five years.[4] The same is true at the state level. One study found that state Attorneys General filed only seven such cases between 1995 and 2004.[5] Even fewer private cases exist. The substantial hurdles a private litigant like

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[4] *See* Robert Pitofsky, *Past, Present, and Future of Antitrust Enforcement at the Federal Trade Commission*, 72 U. Chi. L. Rev. 209, 224 (2005) ("During the Reagan years no challenges were advanced against RPM under either a per se or a rule of reason theory. There were a few challenges in extreme circumstances to RPM during the first Bush administration. Then federal enforcement was substantially restored during the Clinton administration, mostly in complaints by the Federal Trade Commission. During the second Bush administration, we find again no challenges to minimum RPM—either under a per se or rule of reason approach.").

[5] *See* Harry First, Statement Before the Antitrust Modernization Commission 22 (Oct. 26, 2005) (transcript *available at* http://www.amc.gov/commission_hearings/pdf/Statement_First.pdf).

Kay's Kloset faces insure that in only those cases, such as this one, where the manufacturer flaunts clear precedent, will any private action even possibly be pursued.[6]

Simply stated, the Fifth Circuit's decision has no widespread impact, and the issues this case raises are neither unsettled nor of particular importance as a practical matter.

III. CONGRESS HAS ENDORSED THE *PER SE* RULE AGAINST VERTICAL MINIMUM PRICE FIXING

In *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51 n.18 (1977), the Court noted that: "[t]he *per se* illegality of price restrictions has been established firmly for many years * * *. Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of individual States." Nothing has changed since 1977 that casts any doubt upon the Court's conclusion that Congress approves of the *per se* illegality treatment of vertical price fixing.

In 1991, in House Report 102-237, Congress recognized its role in selecting the standard governing vertical pricing agreements:

> With the possible exception of merger policy, there is probably no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts and enforcement agencies as in the

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[6] One commentator characterized the current dealer termination law as "a toothless legal standard, providing a blank check for coercion and exclusionary behavior by powerful dealers openly policed by manufacturers, which is structurally designed to make it difficult if not impossible for injured private plaintiffs to recover." Mark E. Roszkowski, *The Sad Legacy of* GTE Sylvania *and Its "Rule of Reason:" The Dealer Termination Cases and the Demise of Section 1 of the Sherman Act*, 22 Conn. L. Rev. 129, 134 (1989).

> area of resale price maintenance ("RPM"). Following the *Dr. Miles* decision in 1911, Congress has revisited the area of resale price maintenance regularly-almost in clockwork 20-year cycles-with special attention to the empirical effects of the policy on consumers and interstate commerce.

1991 W.L. 206791 at 3 (footnote omitted). The history of legislation in this area further confirms the accuracy of this statement. *See* John F. Seiberling, *Congress Makes the Laws: The Executive Should Enforce Them*, 53 Antitrust L.J. 175, 176-78 (1984).

In 1937, Congress enacted the Miller-Tydings Act, Pub. L. No. 314, ch. 690, Title III, 50 Stat. 693 (1937), which permitted states to authorize manufacturers to enter into agreements with retailers fixing minimum product prices. When the Court held that such agreements could not be enforced against non-signers in *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. at 384, Congress responded by enacting the McGuire Act, Pub. L. No. 543, ch. 745, 66 Stat. 632 (1952). Together those two acts allowed manufacturers to enter into minimum price agreements with retailers and to terminate dealers who violated those agreements.

Congress evaluated the lessons learned from the decades of permitted resale price maintenance in the mid 1970s. The Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, repealed the Miller-Tydings and McGuire Acts. At the time it passed the 1975 repeal, Congress noted that legally-sanctioned resale price maintenance resulted in an 18-20% increase in the prices of fair traded goods and that business failures in fair trade states were 55% higher than in non-fair trade states. Senate Comm. on the Judiciary, 94th Cong., Act to Repeal Enabling Legislation for Fair Trade Laws, S. Rep. No. 94-466, at 3 (1975).

Congress intended and expressly recognized that the repeal of these acts would make vertical minimum price fixing

agreements illegal: "Without these exceptions the agreements they authorize would violate the antitrust laws." *Id.* President Ford's signing statement also recognized that the Consumer Goods Pricing Act would "make it illegal for manufacturers to fix the price of consumer products sold by retailers." President Gerald R. Ford, Statement on the Consumer Goods Pricing Act of 1975 (Dec. 12, 1975), *available at* http://www.presidency.ucsb.edu/ws/index.php?pid=5432.http://www.presdiencyhttp://presidency.ucsb.edu/ws/index.php?pid=5432.

Congress has since reaffirmed its support for keeping vertical minimum price fixing agreements illegal *per se*. Congress repeatedly has voted to prevent the Department of Justice from using appropriated money to seek to overturn the *per se* treatment of vertical price fixing. Act of Oct. 11, 1983, Pub. L. No. 98-116, 97 Stat. 795; Act of Dec. 19, 1985, Pub. L. No. 99-190, 99 Stat. 1185.

In 1991, some members of Congress sought to adopt, by legislation, a *per se* standard, while at the same time overturning some of the restrictions placed on plaintiffs by this Court in *Monsanto* and *Sharp*. Although bills adopting the *per se* rule passed both houses of Congress, ultimately other differences in those bills resulted in no bill becoming law.

Recently, Congress has been evaluating whether changes need to be made to the antitrust laws. In 2002, Congress established the Antitrust Modernization Commission. *See* Antitrust Modernization Commission Act of 2002, Pub. L. No. 107-273, 116 Stat. 1856 (2002). That Commission convened in 2004 and solicited comments from interested parties. Some advocates opined that vertical restrictions should be tightened, while others argued that resale price maintenance either should be legalized or governed by the

rule of reason standard. Still others believed in preserving the status quo.[7]

In January 2005, the Antitrust Modernization Commission decided that there was no need for a legislative change in the standard. This conclusion was reached based upon the differing opinions about whether treatment of vertical price fixing was too strict or too lenient, and "Congressional support year in, year out for maintenance of the *per se* rule." *See* Transcript of Jan. 13, 2005 Meeting, Antitrust Modernization Commission, http://www.amc.gov/pdf/meetings/051113_Meeting_Transcript_reform.pdf.http://www.amc.gov/pdf/meetings/Single-FirmConduct.pdf.

In a concurrence to *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), Justice Brennan noted that the Solicitor General urged that *Dr. Miles* be overruled. In his concurrence, Justice Brennan stated:

> That decision has stood for 73 years, and Congress has certainly been aware of its existence throughout that time. Yet Congress has never enacted legislation to overrule the interpretation of the Sherman Act adopted in that case. Under these circumstances, I see no reason for us to depart from our longstanding interpretation of the Act.

Id. at 769.

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[7] Robert H. Bork commented: "The antitrust laws, in my opinion, are performing well, in fact better than at any time in the past seventy-five years. It follows that there is very little need for 'modernization.'

"This is not to say that all cases are being decided correctly, but such mistakes as are being made are due more to the human element, which can never be eradicated, than to any systematic flaws in antitrust doctrine." Memorandum from Robert H. Bork to the Antitrust Modernization Committee 1 (no date) (on file with author), *available at* http://www.amc.gov/comments/bork.pdf.

In *Flood v. Kuhn*, 407 U.S. 258 (1972), the Court considered the propriety of *Federal Baseball Club of Baltimore v. National League of Professional Baseball Clubs*, 259 U.S. 200 (1922), the case establishing an exemption from the antitrust laws for professional baseball, and *Toolson v. New York Yankees, Inc.*, 346 U.S. 356 (1953), which had reaffirmed *Federal Baseball*. In refusing to overturn these cases, the Court stated:

> We continue to be loath, 50 years after *Federal Baseball* and almost two decades after *Toolson*, to overturn those cases judicially when Congress, by its positive inaction, has allowed those decisions to stand for so long and, far beyond mere inference and implication, has clearly evinced a desire not to disapprove them legislatively.

Kuhn, 407 U.S. at 283-84. The remedy, if any, was for Congress, and not for the Court.

Given Congress's even longer, and more active role in setting antitrust policy in the area of resale price maintenance than in the area of the baseball exemption, a more compelling case exists for deferring to Congress to change the law, should any change be needed. In light of Congress's longstanding and current approval of *per se* treatment of minimum vertical price fixing, it is both inappropriate and unnecessary for this Court to revisit *Dr. Miles*.

IV. MODERN ECONOMIC ANALYSIS DOES NOT SUGGEST RECONSIDERING THE *PER SE* RULE

Economists and "law and economics" scholars have given some attention to the issue of Resale Price Maintenance in the last twenty years. Importantly, their conclusions have not validated the pure Chicago School approach Leegin advocates in its Petition:

> [U]nder post-Chicago antitrust analysis, the market has become a far messier place. The post-Chicago economic

> literature has produced impressive arguments that certain market structures and certain types of collaborative activity are much more likely to have anticompetitive consequences than Chicago School antitrust writers imagined.

Herbert Hovencamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 Colum. Bus. L. Rev. 257, 270 (2001).

Instead, collective experience includes many instances when the elimination of resale price maintenance has led to significant savings for consumers. For example, brand name soft white light bulb prices fell more than thirty percent between 1980 and 2002, following the elimination of resale price maintenance and other vertical restrictions; experience in the United Kingdom, France and Sweden showed that retail price maintenance impeded the growth of low-cost, low margin distributors; the elimination of resale price maintenance is associated with a decline in margins by drug stores—margins have dropped from the traditional 40% level to 20%; and ending Levi Strauss's resale price maintenance in 1976 resulted in annual gain in consumer surplus exceeding $200 million for men's jeans alone. F.M. Sherer, *Comment on Cooper et al.'s "Vertical Restrictions and Policy,"* Competition Pol'y Int'l, Autumn 2005, at 65, *available at* http://www.esapience.org/render_cms_image.aspx?item=Id611&detailID=151.http://www.esapience.org/render_cms_image.aspx?item=Id611.

Numerous anticompetitive explanations for resale price maintenance are now recognized. These include the ability of such restrictions to facilitate cartelizing a market, *i.e. Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. at 51 n.18, which may well have been Leegin's goal in this case.

The elimination of intrabrand competition leads to a number of potential problems. *First*, increased efficiency available from price flexibility is eliminated. For example, Leegin's national system of price controls prevented prices

from reflecting local conditions or temporal changes in demand. *See* VIII Phillip E. Areeda, *Antitrust Law* ¶1631a5 (1989) (noting that price stability "is hardly a worthy object for antitrust law. Although price instability and confusion may occasionally impose costs on society, price stabilization remains generally pernicious.").

Second, resale price maintenance has been associated with the preservation of outmoded means of distribution. The existence of a guaranteed margin provides retailers with little incentive for innovation in their retail practices.[8]

Third, manufacturers are shielded from competitive pressure that could arise from vigorous competition among the retailers of the manufacturers' products. If a manufacturer cannot guarantee a retail margin, a manufacturer may have to engage in price competition with other manufacturers to attract retailers for its product. Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1492 (1983).

Fourth, providing a guaranteed margin on sales of one brand to a retailer can induce the retailer to pressure consumers to move from other products that better fit consumers' needs to the favored brand. Such behavior is not the result of an efficient market. Areeda, *supra*, ¶1601, at 15.

Fifth, to the extent that resale price maintenance leads to a competitive increase in retailer services, some customers will receive unnecessary and unneeded services, making them worse off because they are forced to pay for unwanted services. William S. Comanor, *Vertical Price-Fixing, Ver-*

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[8] Robert L. Steiner, *The Evolution and Applications of Dual-Stage Thinking*, XLIX The Antitrust Bull. 877, 899 (2004) ("The greatest social welfare loss from (voluntary) vertical restraints * * * has arisen from * * * vertical price restraints that have historically retarded the growth of a series of new and more efficient forms of retailing * * *.").

tical Market Restrictions, and the New Antitrust Policy, 98 Harv. L. Rev. 983, 999 (1985).

Much attention has been given to the question of whether these recognized inefficiencies can be reliably cured by interbrand competition. Reliance on interbrand competition seemed to underlie the Court's holdings in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. at 36. The picture that emerges from much of the work analyzing the economics of product differentiation and distribution presents a much more complex situation than contemplated in *Sylvania.* The belief that all markets will address any artificial anticompetitive behavior is no longer accepted. Today, "few Chicago school advocates would say that vertical restraints are never harmful." Pamela Jones Harbour, *An Enforcement Perspective on the Work of Robert L. Steiner: Why Retailing and Vertical Relationships Matter*, XLIX The Antitrust Bull. 985, 997 (2004).

In *Sylvania* the Court stated that interbrand competition "provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." 433 U.S. at 53 n.19. Subsequent research has disputed this claim. Research has shown that "the more competitive is interbrand competition among manufacturers, the less competitive is intrabrand competition likely to be and the larger the markups in the distribution sector." Steiner, *supra*, at 898. *See also* Michael P. Lynch, *Why Economists are Wrong to Neglect Retailing and How Steiner's Theory Provides an Explanation of Important Regularities*, XLIX The Antitrust Bull. 911, 927-29 (2004) (showing how retail margins on leading brands are smaller than margins on store brands).

In addition to the question whether resale price maintenance reduces efficiency, other competing policies are implicated. Resale price maintenance involves a shift in

wealth from consumers to producers. Thus, resale price maintenance involves a decrease in consumer welfare.

Even Leegin's authorities recognize that "when a manufacturer successfully discourages its retailers from discounting, the higher quasi rents it reaps come at consumers' expense and that merchandise that might have been sold ends up being destroyed." David A. Butz, *Vertical Price Controls With Uncertain Demand*, 40 J.L. & Econ. 433, 456 (1997).

These recent insights demonstrate that pure Chicago School thought places too much faith in the ability of markets to correct anticompetitive actions:

> Chicago antitrust economics was oversold. If markets are not as elegant as Chicago economists assume, if information and switching costs are in fact quite high, if proportions can be varied, if products are durably differentiated, then markets can in fact be anticompetitive over a variety of circumstances that Chicago economists generally disallowed.

Hovenkamp, *supra*, at 268.

As a result, scholars recognize that the legal standards governing vertical conduct cannot and should not be dependent solely upon economic analysis:

> Firms will get away with welfare-reducing practices if competition policy is too lenient, and they will be discouraged from engaging in welfare-enhancing practices if it is too strict. Sound policy must thus begin with an assessment of the likelihood and cost of the two types of mistakes. Policymakers must then devise rules that minimize the expected costs of these errors and make antitrust enforcement predictable for businesses.

David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. Chi. L. Rev. 73, 80 (2005). "In the interests of judicial economy * * * it may be more expeditious to set

general policy standards, even though they will sometimes lead to improper results." Comanor, *supra*, at 1001.

Rather, economic analysis lacks the tools and sophistication to assess accurately the efficiency aspects of resale price maintenance in a market such as fashion, a market characterized by a high degree of product differentiation. But the obvious and inevitable impact of resale price maintenance—recognized by everyone—is that *consumers pay more*. Under these circumstances, the permissibility of vertical price fixing must be guided in large part by past experience and common sense, precisely the considerations upon which the *per se* rule of *Dr. Miles* relies. Indeed, it is imperative to safeguard practices that result in lower consumer prices, since "cutting prices to increase business often is the very essence of competition." *State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997).

V. *STARE DECISIS* PRINCIPLES COUNSEL AGAINST REVISTING *DR. MILES*

Given all of the foregoing reasons, general principles of *stare decisis* counsel against revisiting the *Dr. Miles* rule. As Justice Breyer observed last term:

> The Court has often recognized the "fundamental importance" of *stare decisis*, the basic legal principle that commands judicial respect for a court's earlier decisions and the rules of law they embody. *See Harris v. United States*, 536 U. S. 545, 556–57 (2002) (plurality opinion) (citing numerous cases). The Court has pointed out that *stare decisis* "'promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process.'" *United States v. International Business Machines Corp.*, 517 U. S. 843, 856 (1996) (quoting *Payne v. Tennessee*, 501 U. S. 808, 827 (1991)). *Stare decisis* thereby avoids the instability and unfairness that ac-

> company disruption of settled legal expectations. For this reason, the rule of law demands that adhering to our prior case law be the norm. Departure from precedent is exceptional, and requires "special justification." *Arizona v. Rumsey*, 467 U.S. 203, 212 (1984). This is especially true where, as here, the principle has become settled through iteration and reiteration over a long period of time.

Randall v. Sorrell, 126 S.Ct. 2479, 2489 (2006). *See also Rasul v. Bush*, 542 U.S. 466, 506 (2004) (Scalia, J., dissenting) ("Departure from our rule of *stare decisis* in statutory cases is always extraordinary * * *.").

Dr. Miles has been the law since 1911. Leegin's Petition raises a question that has not only been decided, it has been settled law for ninety-five years. As recently as 1997, this Court has reiterated that agreements to fix minimum prices "remain illegal *per se*." *State Oil Co. v. Khan*, 522 U.S. at 17. *See also NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 136 (1998) (recognizing vertical pricing conduct falls within scope of *per se* rule). The reasons for applying the doctrine of *stare decisis* are compelling here. "Considerations of *stare decisis* are particularly forceful in the area of statutory construction, especially when a unanimous interpretation of a statute has been accepted as settled law for several decades." *IBP, Inc. v. Alvarez*, 126 S.Ct. 514, 523 (2005).

Furthermore, Congress has been active in this area and its intent is clear. Indeed, in *Sylvania*, this Court recognized that Congress repeatedly had expressed its approval of the *per se* rule. And Congress's actions since 1977 only affirm its support for the *per se* rule.

Ultimately, the *Dr. Miles* rule is clear and easily enforceable. And it is consistent with modern economic analysis. Rule of reason analysis—which Leegin proposes in its Question Presented—would eliminate this clarity and inevitably result in substantial harm to consumers who will pay

higher prices. No "compelling reason" requires that result nor this Court's review of the issue. Sup. Ct. R. 10.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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November 6, 2006

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IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes,
Respondent.

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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RULE 29.6 STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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REPLY BRIEF FOR PETITIONER

Nothing in PSKS's Opposition Brief diminishes the stark conflict between *Dr. Miles*' antiquated *per se* rule against resale price maintenance and this Court's modern antitrust jurisprudence, which restricts the use of *per se* rules to practices that "*always* or *almost always* tend to restrict competition and decrease output." *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 19-20 (1979) (emphases added). PSKS makes no attempt whatsoever to demonstrate that resale price maintenance always or almost always reduces competition. Rather, PSKS argues that resale price maintenance is not universally procompetitive because there are some "anticompetitive explanations for resale price maintenance." Opp. at 16. This Court has repeatedly made clear, however, that the mere possibility that a practice may lead to anticompetitive effects in some circumstances is not a sufficient basis for establishing a *per se* prohibition. *See Broadcast Music, Inc.*, 441 U.S. at 19-20; *see also State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997) ("we have expressed reluctance to adopt *per se* rules . . . where the economic impact of certain practices is not immediately obvious" (internal quotation marks omitted)).

Similarly, PSKS makes no effort to suggest that the rule of reason would invariably—or even frequently—condemn resale price maintenance. *See Khan*, 522 U.S. at 10 (a *per se* rule is only appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it"). The effect of PSKS's approach would be to condemn a significant amount of activity that could enhance competition and benefit consumers—such as Leegin's use of resale price maintenance in this case—regardless of the economic effect of the practice. Indeed, PSKS argues that the "legal standards governing vertical conduct" should not be based on "economic analysis." Opp. at 19-20. In *Sylvania*, however, this Court explicitly rejected the approach that PSKS advocates, holding instead

that a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than ... upon formalistic line drawing." *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977); *see also Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988). That PSKS is forced to rely on such an argument to defend the rule of *Dr. Miles* merely underscores the conflict between that rule and this Court's decisions in *Sylvania*, *Sharp*, and other modern cases. That conflict is itself reason to grant Leegin's petition and re-examine the rule of *Dr. Miles*.

A. PSKS's Argument About A Purported Horizontal Cartel Is A Red Herring, Which PSKS Raised For The First Time In Its Opposition Brief.

PSKS's primary argument in its Opposition Brief is that the Court should disregard the fundamental legal and economic flaws in the rule of *Dr. Miles* because this case supposedly involves a horizontal cartel. Opp. at 1-8. PSKS's attempt to raise this argument at this late stage of the litigation is surprising because PSKS has never once—not in the district court, not in the Fifth Circuit, and not in its opposition to Leegin's application to stay the Fifth Circuit's mandate—argued that *per se* treatment is appropriate for any reason other than *Dr. Miles*' *per se* prohibition of vertical resale price maintenance agreements. Not surprisingly, the courts below did not address this newly minted horizontal theory, but rather based their holdings on the rule of *Dr. Miles*.[1] This case thus squarely presents the question of the viability of *Dr. Miles*, and the Court should reject PSKS's transparent

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[1] The district court denied Leegin's motion for judgment as a matter of law or for a new trial based on the rule of *Dr. Miles*. *See* Pet. App. at 12a ("Nearly a century ago, *Dr. Miles* prescribed vertical minimum price fixing agreements unlawful under Section 1. Whether the per se classification of such agreements is wise is not for this court to decide." (citation omitted)). Likewise, the Fifth Circuit affirmed based on the rule of *Dr. Miles*. *See* Pet. App. at 4a ("Because the Court has consistently applied the *per se* rule to [vertical minimum price-fixing agreements], we remain bound by its holding in *Dr. Miles Medical Co.*").

and belated attempt to recharacterize this case as being about something other than a vertical restraint.

Even if PSKS had raised this issue below, there is no support for its suggestion that a restraint on intrabrand retail competition established by a dual-distributing manufacturer should be subject to the *per se* rule against horizontal restraints. To the contrary, this Court and numerous courts of appeals have rejected attempts to characterize such arrangements as *per se* unlawful horizontal agreements.[2]

In addition, there is no reason for Leegin to organize a cartel among its retailers, which (assuming a cartel in this fragmented retail marketplace could even be maintained) would have the effect of boosting retail margins and reducing the volume of its own sales.[3] Moreover, in the diverse mar-

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[2] In *White Motor Co. v. United States*, 372 U.S. 253 (1963), which involved territorial and customer restrictions by a dual-distributing manufacturer, *id.* at 255, the Court treated the restrictions as involving a "vertical arrangement," *id.* at 261, rejecting the Government's argument that the restrictions should be treated as a horizontal arrangement. Similarly, in *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967), although Schwinn sold bicycles through a dual distribution system, including sales to wholesale distributors for resale to retailers and direct sales to retailers in competition with its distributors, *id.* at 370, the Court noted that "[w]e are here confronted with challenged vertical restrictions as to territory and dealers. The source of the restrictions is the manufacturer. These are not horizontal restraints . . . ." *Id.* at 372. Numerous post-*Sylvania* decisions have likewise treated distribution restraints established by a supplier engaged in dual distribution as vertical. *See, e.g., Smalley & Co. v. Emerson & Cuming, Inc.*, 13 F.3d 366, 368 (10th Cir. 1993); *Ill. Corp. Travel v. Am. Airlines, Inc.*, 889 F.2d 751, 753 (7th Cir. 1989); *Int'l Logistics Group, Ltd. v. Chrysler Corp.*, 884 F.2d 904, 906 (6th Cir. 1989); *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1230-31 (8th Cir. 1987).

[3] As Judge Easterbrook recently observed in affirming summary judgment against a dealer who alleged that a manufacturer had organized its dealers into a retail cartel, "[p]roducers gain when the costs of distribution are lowest; a retail cartel that charged a monopoly price for distribution services would hurt [the manufacturer] as well as (if not more than) ultimate consumers, so it is a surprise to see [the manufacturer] ac-

ketplace for women's fashion accessories, any effort to promote supracompetitive profits for retailers of Leegin's goods would simply divert consumer traffic to the numerous other brands that are sold in countless other outlets.[4] Contrary to PSKS's unsupported cartel theory, Leegin's independent interest as a manufacturer was to have its retailers sell its products with the lowest margin consistent with effective marketing of its products, which is entirely consistent with Leegin's effort to establish a retail price floor to encourage service competition among its dealers.

B. PSKS Has Utterly Failed To Respond To Leegin's Arguments Supporting Certiorari.

As noted above, PSKS provides no response to the conflict between the rule of *Dr. Miles* and the treatment of vertical restraints in this Court's modern cases, including *Sylvania* and *Sharp*. In addition, PSKS has not even attempted to respond to a number of other arguments set forth in Leegin's petition that strongly support reviewing the decision below and overturning the rule of *Dr. Miles*.

1. PSKS does not dispute Leegin's argument that there are substantial procompetitive uses of resale price maintenance—an argument that was echoed in the *amicus curiae* brief submitted by 25 distinguished economists. *See* Brief of *Amici Curiae* Economists at 4-11. PSKS likewise fails to provide any analysis grounded in economics to suggest that resale price maintenance "would always or almost always tend to restrict competition and decrease output." *Broadcast Music, Inc.*, 441 U.S. at 19-20.[5]

[Footnote continued from previous page]

cused of facilitating its own injury." *R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!*, 462 F.3d 690, 696-97 (7th Cir. 2006).

[4] *See* Expert Report of Kenneth G. Elzinga ("Elzinga Report") at 13-15 (Pet. App. at 30a-32a).

[5] The closest PSKS comes to such an analysis is its attempt to resurrect the long-discredited notion from *Dr. Miles* that "the suppression of

Instead, PSKS attempts to invoke a novel standard for the application of *per se* rules by arguing that there are some "anticompetitive explanations for resale price maintenance" (Opp. at 16-17)—that is, the practice might have anticompetitive effects *in some circumstances*. This proposition, which Leegin does not dispute,[6] does not support imposing a sweeping *per se* prohibition on resale price maintenance. Indeed, the same can be said for vertical territorial restraints, which might *sometimes* have anticompetitive effects but are nevertheless evaluated under the rule of reason. *See Sylvania*, 433 U.S. at 59 ("[w]hen anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason"); *Khan*, 522 U.S. at 22 (same). The real issue, under this Court's long-standing requirements for the use of *per se* rules, is whether there is economic support for the proposition that resale price maintenance *almost always* has anticompetitive effects and *almost never* has procompetitive effects. There is none.

2. PSKS does not dispute that the rule of *Dr. Miles* has been subject to substantial academic and judicial criticism. *See* Petition at 6, 10-18; *see also* Brief *Amicus Curiae* of

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[Footnote continued from previous page]

competition among dealers by the manufacturer has the same practical effect as an agreement among the dealers themselves to suppress competition." Opp. at 9. This argument is contrary to the Court's holding in *Sylvania*, 433 U.S. at 58-59, and it has been overwhelmingly rejected by economists and legal scholars. *See, e.g.*, 7 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1620d (2d ed. 2004) ("To the extent that *Dr. Miles* rests on the false categorical propositions that resale price maintenance never benefits manufacturers and always has the same effects as an illegal dealer cartel, its ruling is ripe for a reexamination the Supreme Court has never given it."); Robert H. Bork, *The Antitrust Paradox* 298 (1978) ("This field of law can be made clear, internally consistent, and congruent with reality only when we face the fact that the premise laid down in *Dr. Miles*—that the vertical elimination of dealer rivalry has the same effect as a horizontal cartel—is incorrect and must be rejected.").

[6] *See* Petition at 16; Elzinga Report at 12-21 (Pet. App. at 29a-38a).

CTIA – The Wireless Association at 5-7; *cf. Sylvania*, 433 U.S. at 47-48 (noting that the "great weight of scholarly opinion ha[d] been critical" of *Schwinn*). In response to the mountain of literature criticizing the *per se* rule against resale price maintenance, PSKS has not identified a single source that either argues for retaining the *per se* rule in its current form or suggests that anticompetitive effects invariably arise when a small manufacturer like Leegin uses resale price maintenance. To the contrary, the very sources cited by PSKS advocate *overturning* the *per se* rule of *Dr. Miles*. For example, PSKS cites an article by Professor F.M. Scherer as purported support for retaining the rule of *Dr. Miles*. Opp. at 16. But Professor Scherer's article does not support such a position. To the contrary, the article states that "[m]y own view has long been that vertical restraints are benign or efficiency enhancing more often than not, leading me to recommend that a rule of reason be applied." F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* Competition Policy Int'l, Autumn 2005, at 65, 74 n.30.[7]

It is also significant to note that Professor Scherer is one of the economists who submitted a brief as *amici curiae* urg-

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[7] The other articles cited by PSKS are similarly unsupportive of the sweeping *per se* rule for which PSKS advocates. *See, e.g.*, Robert L. Steiner, *The Evolution and Applications of Dual-Stage Thinking*, 49 Antitrust Bull. 877, 899 (2004) (arguing that "antitrust intervention against firms that have adopted vertical price or distribution restraints must be confined to brands that enjoy a very strong consumer franchise"); William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 1001-02 (1985) ("[I]n the case of new products or products of new entrants into the market, vertical restraints . . . should be permissible, or at least should be treated more leniently in [a] . . . rule of reason analysis."); Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1495 (1983) (suggesting that there should be "exceptions to a *per se* rule" or a "'characterization' step" in which a court determines whether to apply the rule of reason or a *per se* rule based on the circumstances of a given case).

ing the Court to grant Leegin's petition and overturn the *per se* rule against resale price maintenance. As that brief explains, there is a disagreement among economists as to whether vertical restraints are always benign or whether they may sometimes lead to anticompetitive effects and therefore should not be viewed as universally procompetitive. *See* Brief of *Amici Curiae* Economists at 15-16. That disagreement in no way supports continued *per se* treatment of resale price maintenance. As the *amici* economists note, there is no support in the literature for the proposition that resale price maintenance most often, much less almost invariably, leads to anticompetitive effects. *Id.* at 16.

C. PSKS's Arguments Are Insufficient To Support Denying Review Or Retaining The Rule Of *Dr. Miles*.

1. PSKS argues that this case does not raise an important issue because federal and state antitrust enforcers have brought "extraordinarily few" challenges to resale price maintenance in recent years and because few private cases have resulted in verdicts for the plaintiffs. Opp. at 9-10. But PSKS is incorrect in equating the number of government challenges or plaintiffs' verdicts with the "everyday importance" of overturning the rule of *Dr. Miles*. Such cases are infrequent because the *per se* rule of *Dr. Miles* deters many businesses from engaging in this efficiency-enhancing practice (Petition at 22-23), there are powerful incentives for manufacturers to settle any cases that are brought (*id.* at 29-30), and, despite the *per se* rule, government enforcers have generally exercised their discretion not to prosecute the practice where it does not harm consumers. That this case provides the Court with a rare opportunity to reconsider the rule of *Dr. Miles* only augments its cert-worthiness.

Similarly, while PSKS is correct that the *Colgate* doctrine and *Sylvania*'s rule-of-reason treatment for vertical nonprice restraints provide a measure of "freedom to companies to lawfully arrange their businesses to achieve permissible economies" (Opp. at 10), there is no rational reason why companies should be prevented from achieving similar

economies through vertical price restraints. Petition at 13-14; *see also* Brief *Amicus Curiae* of the Nat'l Ass'n of Mfrs. at 11-12. Retaining the *per se* rule against just one type of vertical restraint merely burdens businesses that could more efficiently compete through vertical price restraints, and it creates an unwarranted trap for companies that attempt to establish a *Colgate* policy but inadvertently stray across the line into an agreement, as occurred in this case.

2. PSKS's argument that resale price maintenance should remain *per se* unlawful because this Court should always "safeguard practices that result in lower consumer prices" (Opp. at 20) is flat wrong as a matter of both law and economics. First, as a matter of economics, the modern economic understanding of vertical restraints demonstrably shows that vertical restraints can enhance efficiency and benefit consumers by fostering interbrand competition, even if they result in higher prices to consumers. *See* Petition at 11-14; Brief of *Amici Curiae* Economists at 11-12. Second, as a matter of law, this Court has long recognized that vertical restraints that result in increased retail prices can enhance interbrand competition and consumer welfare. Indeed, as the Court explained in *Sharp*, that is precisely why vertical nonprice restraints were held to be subject to the rule of reason in *Sylvania*. 485 U.S. at 728 ("[V]ertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services."). The effect on retail prices and interbrand competition that justified rule-of-reason treatment in *Sylvania* simply cannot be used to justify *per se* treatment here.

3. PSKS also contends that there has been congressional support for retaining the rule of *Dr. Miles*. Opp. at 11-15. As Leegin pointed out in its petition, however, Congress has never passed legislation requiring that resale price maintenance be treated as *per se* unlawful, and it has never taken away this Court's power to interpret the antitrust laws or define the *per se* rules that the Court has created. *See* Petition at 26-27. PSKS does not respond to these points.

Instead, PSKS quotes from a 1991 House Report in connection with legislation that never passed. Opp. at 11-12. Similarly, PSKS quotes from dicta in this Court's opinion in *Sylvania* and Justice Brennan's concurrence in *Monsanto* (Opp. at 11, 14), but the viability of the rule of *Dr. Miles* was not before the Court in either of those cases.[8] The passages quoted by PSKS are obviously no substitute for actual legislation from Congress mandating *per se* treatment of resale price maintenance—which does not exist.

PSKS also quotes a statement from a meeting of the Antitrust Modernization Commission ("AMC") about the AMC's decision not to study changes to the law of resale price maintenance. Opp. at 13-14.[9] Obviously, such a statement is not the equivalent of legislation from Congress. The AMC is not a legislative body; it was instead granted limited authority to study issues and prepare a report. *See* Pub. L. No. 107-273, § 11053, 116 Stat. 1758, 1856 (2002). Moreover, the AMC, which has not issued a formal report, has taken no position on the propriety of the rule of *Dr. Miles*.

Apparently recognizing that Congress has never mandated adherence to the rule of *Dr. Miles*, PSKS falls back on the notion of Congress's "positive inaction." Opp. at 15. PSKS fails to note, however, that this Court emphatically re-

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[8] PSKS incorrectly asserts that "[o]n several occasions" the Court has "reconsidered" and "reaffirmed" the *per se* rule against resale price maintenance. Opp. at 2. To the contrary, the Court has not considered the viability of this rule in *Sylvania*, *Sharp*, *Monsanto*, *Khan*, or any other recent case. To the extent the Court referred to the rule of *Dr. Miles* in any of those cases, it was simply describing the state of the law, not making an advisory ruling that the rule should be preserved in perpetuity.

[9] In discussing the AMC's decision, PSKS curiously omits mention of the report of the working group that assessed whether the AMC should study whether "resale price maintenance [should] be defined legislatively as a Rule of Reason offense." AMC Working Group Mem. 14 (Dec. 21, 2004), *at* http://www.amc.gov/pdf/meetings/Single-FirmConduct.pdf. That report recommended that the AMC not study the issue, but instead "stand aside and let the common law process work." *Id.* at 16.

jected the same argument from the respondents in *Khan*, who cited the same cases as does PSKS. *See Khan*, 522 U.S. at 19 (explaining that the decisions regarding the antitrust exemption for professional baseball "are clearly inapposite," and "infer[ring] little meaning from the fact that Congress has not reacted legislatively to *Albrecht*"). As the Court explained in *Khan*, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress expected the courts to give shape to the statute's broad mandate" and to reevaluate previous interpretations undermined by the passage of time. *Id.* at 20.

4. Finally, PSKS asserts that "general principles of *stare decisis* counsel against revisiting the *Dr. Miles* rule." Opp. at 20. PSKS, however, omits any mention of either the Court's treatment of this issue in *Khan*, in which the Court rejected the same argument that PSKS now raises, or the long line of cases in which this Court has emphasized the dynamic nature of the Sherman Act and the role of the Court in adapting the law to "the lessons of accumulated experience." *Khan*, 522 U.S. at 21; *see also* Petition at 24-25.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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November 20, 2006

MOTION FILED

NOV 6 - 2006

No. 06-480

In the Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

PETITIONER

v.

PSKS, INC., D/B/A KAY'S KLOSET . . . KAY'S SHOES,

RESPONDENT

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF CTIA – THE WIRELESS ASSOCIATION AS *AMICUS CURIAE* SUPPORTING PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Under Rule 37.2 of the Rules of this Court, CTIA – The Wireless Association moves for leave to file the accompanying brief as *amicus curiae* in support of the petition for a writ of certiorari. Counsel for petitioner has consented to the filing of this brief, but counsel for respondent has refused consent.

CTIA – The Wireless Association represents all segments of the wireless communications industry. Members of CTIA include service providers, manufacturers, wireless data and Internet companies, and other industry participants. CTIA has filed *amicus* briefs in this Court and other federal courts on a variety of issues of interest to the wireless industry in such disparate cases as *Bartnicki* v. *Vopper*, 532 U.S. 514 (2001), *City of Rancho Palos Verdes* v. *Abrams*, 544 U.S. 113 (2005), and *Bell Atlantic Corp.* v. *Twombly*, No. 05-1126 (to be argued Nov. 27, 2006).

Members of CTIA sell a variety of sophisticated communications products, such as Internet-accessible mobile phones, that benefit from point-of-sale consumer services. The Court's decision on the question presented here will directly affect how those companies market such devices.

CTIA – The Wireless Association therefore should be granted leave to file the attached *amicus* brief.

Respectfully submitted.

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NOVEMBER 2006

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BRIEF OF *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*[1]

The interest of the *amicus curiae* is described in the accompanying motion for leave to file this brief.

SUMMARY OF ARGUMENT

I. There is a consensus among lower courts, antitrust scholars, and economists that vertical restrictions on intrabrand competition are usually procompetitive and beneficial to consumers. There is no serious intellectual support for the proposition that such restrictions are always anticompetitive (or nearly so) and deserving of *per se* condemnation. Minimum resale price maintenance is one such vertical restriction.

Manufacturers, and intermediate distributors such as members of *amicus* CTIA, limit intrabrand retail price competition for legitimate and procompetitive reasons in a wide range of industries. By guaranteeing a minimum gross margin between wholesale and retail prices, a manufacturer or intermediate distributor can enlarge the number of retailers that are willing to sell the product and create and preserve retailers' incentives to invest in valuable non-price competitive behavior, such as advertising and promoting the product. Retailers' incentives to provide such costly services are severely undermined when a competitor offers lower prices without providing them and without incurring the associated costs. Manufacturers and intermediate distributors have legitimate interests in preventing this free-riding

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[1] Under S. Ct. R. 37.6, *amicus curiae* states that no counsel for a party has written this brief in whole or in part and that no person or entity other than the amicus curiae or their counsel has made a monetary contribution to the preparation or submission of this brief.

behavior, and consumers benefit from receiving the services that vertical price restraints can promote. The current *per se* treatment of minimum resale price maintenance imposes large costs on businesses and consumers alike.

II. The arguments offered in defense of retaining the *per se* rule are unpersuasive. In *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court justified a ban on resale price maintenance on the ground that the practice is an unlawful restraint on alienation. That theory did not survive this Court's later decisions rejecting a rule of *per se* invalidity for vertical nonprice restraints and for maximum resale price restraints. *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977); *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997). This *per se* rule also is defended on the ground that it is necessary to prevent resale price maintenance from being used to enforce a manufacturer- or distributor-level price-fixing cartel. But resale price maintenance does not invariably—or even usually—stem from or lead to cartelization, this practice is not invariably anticompetitive, and the rule of reason and direct prohibitions on cartels are sufficient to police resale price maintenance for potential cartel activity. Finally, some argue that Congress has endorsed the *Dr. Miles* rule. But no positive law today dictates that resale price maintenance be deemed unlawful *per se*, and the legislation used to support this congressional-acceptance argument was repealed long ago.

III. This Court has recognized that *stare decisis* has limited weight in the antitrust arena, where Congress intended that liability rules would be adjusted in light of judicial experience. The weight to be accorded to *stare decisis* is, in any case, a question that can be considered at the merits stage and should not dissuade the Court from re-examining a precedent that has been as thoroughly discredited as this one.

ARGUMENT

THE ANTITRUST LAWS SHOULD NOT TREAT MINIMUM RESALE PRICE MAINTENANCE AS A *PER SE* UNLAWFUL BUSINESS PRACTICE

Section 1 of the Sherman Act proscribes concerted action only if it unreasonably restrains competition. Ordinarily, courts determine whether particular conduct is anticompetitive through a case-specific application of a Rule of Reason, which requires the factfinder to assess the relevant considerations in deciding whether a practice is an unreasonable restraint on competition.[2] Certain practices, however, are deemed *per se* illegal, dispensing with the need for case-by-case evaluation. But since *per se* rules of illegality condemn practices without even asking if they promote competition in a particular setting, they create a risk of falsely condemning procompetitive conduct.[3] Accordingly, *per se* rules of illegality are appropriate only for "conduct that is manifestly anticompetitive."[4] Proponents of any such rule have the burden of proving, "based upon demonstrable economic effect,"[5] that it is "'immediately obvious'" or known through "'experience'"[6] that a practice has "a pernicious effect on competition and lack[s] * * * any redeeming virtue"[7] because it "'would always or almost always tend to restrict

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[2] *See, e.g., Texaco, Inc.* v. *Dagher*, 126 S. Ct. 1276, 1279 (2006); *Sylvania*, 433 U.S. at 49; *Chicago Board of Trade* v. *United States*, 246 U.S. 231, 238 (1918); *Standard Oil Co.* v. *United States*, 221 U.S. 1, 60 (1911).

[3] *See Polygram Holding, Inc.* v. *FTC*, 416 F.3d 29, 34 (D.C. Cir. 2005) (Ginsburg, C.J.).

[4] *Sylvania*, 433 U.S. at 49.

[5] *Sylvania*, 433 U.S. at 58-59.

[6] *Khan*, 522 U.S. at 10 (quoting *Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332, 344 (1982)).

[7] *Northern Pacific Ry.* v. *United States*, 356 U.S. 1, 5 (1958).

competition and decrease output.'"[8] A particular business practice therefore should be held *per se* unlawful only when "'experience'" with it will "'[e]nable the Court to predict with confidence that the rule of reason will condemn it.'"[9]

Under that approach, minimum resale price maintenance should not be deemed unlawful *per se* for three reasons. *First*: Resale price maintenance directly and ordinarily serves legitimate, procompetitive goals. Among other things, the practice is used to create incentives for retailers to engage in product advertising and promotion, to maintain adequate inventory, and to train sales personnel to explain new or complex products. Manufacturers and intermediate distributors could reasonably believe that resale price maintenance is necessary to prevent some retailers from free riding off the presale services supplied by others, and market forces will provide the necessary discipline if they are wrong, because inefficient practices will result in loss of sales to *interbrand* competitors. *Second*: The rationale for a rule of *per se* illegality has become obsolete over time. The Court adopted that rule in 1911 in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373, before it had experience with vertical restraints. Since then, the Court has rejected *per se* rules in closely analogous circumstances.[10] Resale price maintenance also is not so inherently likely to serve as a façade or tool for price fixing that it should be condemned without giving a party a chance to defend its use. *Third*: *Stare*

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[8] *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985) (quoting *Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1, 19-20 (1979)); *Khan*, 522 U.S. at 10.

[9] *Khan*, 522 U.S. at 10 (quoting *Maricopa*, 457 U.S. at 344).

[10] *State Oil* v. *Khan*, 522 U.S. 3 (1997) (rejecting a *per se* rule of illegality for maximum resale price maintenance); *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977) (rejecting a *per se* rule of illegality for nonprice vertical restraints); *cf. Illinois Tool Works* v. *Independent Ink, Inc.*, 546 U.S. 164, 126 S. Ct. 1281 (2006) (rejecting a *per se* rule that a patent creates monopoly power).

decisis considerations should not stand in the way of abandoning a competitively damaging rule that this Court would not adopt today in the first instance.

I. MINIMUM RESALE PRICE MAINTENANCE COMMONLY SERVES LEGITIMATE, PROCOMPETITIVE PURPOSES AND SHOULD NOT BE OUTLAWED ACROSS THE BOARD

A. Manufacturers and intermediate distributors use vertical restraints for a host of legitimate, procompetitive reasons. In one fashion or another vertical restraints are designed and operate to promote interbrand competition among rivals by restraining intrabrand competition among multiple dealers offering the same product. Over the last 30 years, this Court has recognized on a number of occasions that vertical restraints can be procompetitive.[11]

Minimum resale price maintenance (also known as RPM) is one type of vertical restraint. Sometimes used in lieu of vertical integration, minimum resale price maintenance constrains the lowest price at which a dealer can offer a supplier's product.[12] Although this Court banned that practice in 1911 in the *Dr. Miles* case, for more than two decades there has been widespread agreement among antitrust scholars[13]

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[11] *See Sylvania*, 433 U.S. at 54 ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984); *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 728 (1988); *Khan*, 522 U.S. at 15-19.

[12] A vertically integrated firm would set its own resale price to consumers, so resale price maintenance is a partial substitute for vertical integration. Roger D. Blair & David L. Kaserman, *Antitrust Economics* 353 (1985).

[13] *See, e.g.*, 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1611 (2d ed. 2004); Robert H. Bork, *The Antitrust Paradox* 280-98 (1993 ed.); William F. Baxter, *The Viability of the Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 935 (1987); Terry Calvani & Andrew G. Berg, *Resale Price Maintenance After* Monsanto*: A Policy Still at*

and economists[14] alike that minimum resale price maintenance is a legitimate business practice that

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War With Itself, 1984 DUKE L.J. 1163, 1180-82; Frank Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 146-48 (1984); Herbert Hovenkamp, *The Antitrust Enterprise* 123-24, 186-91 (2005); Timothy J. Muris, *Improving the Economic Foundations of Competition Policy*, 12 GEO. MASON L. REV. 1, 17 (2003); Richard A. Posner, *Antitrust Law* 172-73, 189 (2d ed. 2001). *But see* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487 (1983).

[14] *See, e.g.*, Roger D. Blair, Jill Boylston Herndon & John E. Lopatka, *Resale Price Maintenance and the Private Antitrust Plaintiff*, 83 WASH. U.L.Q. 657, 659, 697-714 (2005); David A. Butz, *Vertical Price Controls With Uncertain Demand*, 40 J.L. & ECON. 433 (1997); Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 423-34 (4th ed. 2005); Yongmin Chen, *Oligopoly Price Discrimination and Resale Price Maintenance*, 30 RAND J. ECON. 441 (1999); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AMER. ECON. REV. 619 (1997); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. ECON. 885 (1996); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991); Benjamin Klein, *The Economics of Franchise Contracts*, 2 J. CORP. FIN. 9 (1995); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265 (1988); Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57 (1998); Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. POL. ECON. 1074 (1986); Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & ECON. 363 (1985); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984); Thomas R. Overstreet, Jr., Bureau of Econ., Fed'l Trade Comm'n, *Resale Price Maintenance: Economic Theories and Empirical Evidence* (Staff Report 1983); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960); Jean Tirole, *The Theory of Industrial*

manufacturers ordinarily use as a means of limiting *intra*brand competition in order to enhance *inter*brand competition, which is the "primary concern of antitrust law."[15]

Minimum resale price maintenance fosters competition and efficiency in many ways. By ensuring a minimum margin between wholesale and retail prices, a manufacturer or intermediate distributor can: (1) ensure that a larger number of retail outlets will carry the product; (2) spur nonprice competition among potential dealers for the right to sell the product; (3) create loyalty and honesty in retailers; (4) prevent deterioration in the image of quality or prestige created by the manufacturer's or intermediate distributor's marketing efforts; and (5) create and preserve retailers' incentives to invest in several forms of valuable non-price competitive behavior. Examples of such procompetitive non-price behavior include, among others: point-of-sale advertising and product promotion to educate consumers about new or complex products; adequate, well-organized inventory and prominent shelf space in individual outlets; the hiring or training of knowledgeable sales personnel to explain products; creation of an attractive shopping environment (*e.g.*, multiple, short cashier lines; convenient, usable product samples, etc.); and the offer of after-sale services. A manufacturer's economic encouragement of these behaviors can cause retailers to create nonprice value for consumers that exceeds the value of a somewhat lower retail price, and therefore enhances demand for the product.

Organization 170-84 (1988); W. Kip Viscusi, John M. Vernon & Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* 283 (4th ed. 2005); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. ECON. 61 (1993).

[15] *Sylvania*, 433 U.S. at 52 n.19; *see also Volvo Trucks North America, Inc.* v. *Reeder-Simco GMC, Inc.*, 546 U.S. 164, 126 S. Ct. 860, 872 (2006).

Efforts by manufacturers or intermediate distributors to offer consumers point-of-sale services are common in a wide range of industries. Consumers benefit directly from receiving the services and indirectly from the augmented interbrand competition. And even dealers can benefit financially from increased consumer demand due to nonprice sales features. In sum all parties can benefit from this practice.[16]

Retailers' incentives to provide costly point-of-sale services are severely undermined when a retailer that provides these services loses sales to a competitor that can offer lower prices because it does not provide such services and therefore does not incur the costs associated with them. A manufacturer or intermediate distributor has legitimate interests in preventing this kind of free-riding behavior, to encourage the provision of these retail services when they allow the manufacturer to engage more effectively in interbrand competition. Yet, without a minimum resale price, dealers knowledgeable or fearful of free-riding competitors would not offer these services, injuring the manufacturer and consumers alike.

The dramatic growth of Internet commerce has vastly increased the threat of free-riding; retailers that provide costly point-of-sale services now lose sales to distant Internet sellers, not just local bricks-and-mortar free riders. If RPM were permissible, manufacturers or intermediate distributors could use that device to distribute their products through the

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[16] Manufacturers vary in their use of resale price maintenance. Some firms may find it useful for retailers to educate consumers about new products or about old ones that are purchased infrequently, such as electronics equipment or vehicles. Other companies may find it valuable to use RPM in lieu of or in conjunction with national advertising. Different manufacturers may abandon RPM over time as consumers gain familiarity with a product. And still other manufacturers may choose to rely entirely on national advertising for consumer education. Telser, 3 J.L. & ECON. at 95-96; Blair & Kaserman, *Antitrust Economics* 350; Mathewson & Winter, 13 REV. INDUS. ORG. at 68.

Internet, while limiting free riding by Internet sellers. Instead, because RPM is now *per se* illegal, manufacturers and intermediate distributors now face the unattractive alternatives of forgoing Internet distribution entirely, or severely undermining the incentives of their bricks-and-mortar retailers to provide valuable point-of-sale services.

Manufacturers and intermediate distributors do not use minimum resale price maintenance as a device to achieve monopoly profits. Such profits require a restriction in supply, yet a vertical restriction affects only one brand; it does nothing to eliminate or reduce interbrand competition. It also would be irrational for a manufacturer to use resale price maintenance to allow distributors to earn a monopoly return; that would be tantamount to giving money to distributors. And if all that a manufacturer wanted were to increase prices, a firm would simply raise the price charged to distributors.[17]

A manufacturer may sometimes misgauge consumer preferences, and a particular decision to promote non-price competition by suppressing intrabrand price competition could conceivably make consumers, on the whole, worse off. The reason, however, is not that the manufacturer has done something anticompetitive, and the reasonable response to

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[17] The same principles apply even when the manufacturer is the dominant firm in an industry. Minimum resale price maintenance does not enable a dominant firm to extract monopoly profits from consumers. If a manufacturer is a monopolist, it can make pricing decisions without need for this restraint, since the exercise of its market power is not itself illegal. Hovenkamp, *The Antitrust Enterprise* 291 (there is no "no fault" antimonopoly rule); *e.g.*, *Berkey Photo, Inc.* v. *Eastman Kodak Co.*, 603 F.2d 263, 294 (2d Cir. 1979); *Blue Cross & Blue Shield United of Wisconsin* v. *Marshfield Clinic*, 65 F.3d 1406, 1412-13 (7th Cir. 1995) (Posner, C.J.) *Alaska Airlines, Inc.* v. *United Airlines, Inc.*, 948 F.2d 536, 548-49 (9th Cir. 1991); *Williamsburg Wax Museum, Inc.* v. *Historic Figures, Inc.*, 810 F.2d 243, 252 (D.C. Cir. 1987); *Kartell* v. *Blue Shield of Massachusetts*, 749 F.2d 922, 927 (1st Cir. 1984); *Trace X Chem., Inc.* v. *Canadian Indus., Ltd.*, 738 F.2d 261, 268 (8th Cir. 1984).

this phenomenon is not strict treble-damage liability for guessing wrong. Because sellers of products can be more profitable by giving consumers what they want than what they do not want, the incentive of the manufacturer is aligned with that of the body of consumers, and a misapprehension of consumers' tradeoffs is merely the result of imperfect information or bad business judgment, not a diminution in competition. Moreover, *inter*brand rivals can take advantage of such a mistake by offering consumers the cheaper, no-frills product if that is what consumers (in the requisite numbers) want. The market, not a court, will "punish" the manufacturer for any mistakes it makes.[18] And here the record facts suggest that petitioner did *not* make any mistake, but rather correctly chose a strategy to advance both its own business interests and consumer welfare. *See* Pet. App. 37a-38a. The self-correcting "problem" of manufacturer restraints that do not in practice optimize consumer welfare for some limited period of time is trivial in comparison to the procompetitive benefits of resale price maintenance, and certainly no reason for a *per se* rule against the practice.

B. This Court has acknowledged that every other means through which manufacturers may limit intrabrand competition can be procompetitive. A manufacturer may lawfully limit intrabrand competition by vertically integrating into retailing;[19] by announcing a suggested retail price and unilaterally terminating any retailer that charges less;[20] by contractually limiting the geographic area or the class of customers that a retailer may serve;[21] and by agreeing with

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[18] *See* 8 Areeda & Hovenkamp, *supra*, ¶ 1612e, at 149.

[19] *See United States* v. *Addyston Pipe & Steel Co.*, 85 F. 271, 287 (6th Cir. 1898) (Taft, J.), *aff'd as modified*, 175 U.S. 211 (1899); *cf. United States* v. *United States Steel Corp.*, 251 U.S. 417 (1920).

[20] *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919); *Monsanto*, *supra*; *Sharp Electronics*, *supra*.

[21] *Sylvania*, *supra*.

retailers on a maximum retail price.[22] Like resale price maintenance, all of these practices have both the purpose and the effect of limiting intrabrand competition, but this Court has recognized that such practices often increase interbrand competition. Their net effect is usually procompetitive, and none of these practices is subject to *per se* condemnation; indeed, the vertical restriction that is the most similar to resale price maintenance—a manufacturer's unilateral policy of refusing to sell to any dealer than charges less than the price "suggested" by the manufacturer—is *per se lawful*.

Judicial experience has confirmed that vertical restraints are almost always procompetitive. When non-price vertical restraints were mistakenly treated as *per se* unlawful, the result was described by Judge Ginsburg (formerly the Assistant Attorney General in charge of the Antitrust Division) as a "plaintiffs' picnic" that produced a surge of meritless antitrust litigation.[23] *Sylvania* corrected that mistake by holding that the legality of non-price vertical restraints must be judged by their actual competitive effects; in the 14 years after *Sylvania* was decided, plaintiffs won in only four of the 45 reported decisions involving non-price vertical restraints.[24] And that sample of 45 litigated cases, of course, involved those restraints that were *most* likely to be anticompetitive. For the vast majority of vertical restraints, no plaintiff even *alleged* an anticompetitive effect. In light of this judicial experience with non-price vertical restraints, there is no reason to believe that resale price maintenance is virtually always anticompetitive. Vertical agreements that limit intrabrand price competition should be treated in the same way as non-price vertical restraints.

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[22] *Khan*, *supra*.

[23] Douglas H. Ginsburg & Leah Brannon, *Determinants of Private Antitrust Enforcement in the United States*, 1 COMPETITION POLICY INT'L 29, 37 (2005).

[24] *Id.* at 42.

Instead, under the *Dr. Miles* rule, businesses are forced to use more costly and less effective devices to limit intrabrand competition rather than resale price maintenance agreements, and to spend large amounts of time and money on antitrust compliance programs designed to ensure adherence to arbitrary distinctions that are as irrational and counterintuitive to business executives as they are to antitrust scholars. These costs are imposed on every manufacturer or intermediate distributor that relies on others to distribute and retail its products. And the beneficiaries of this complexity are not consumers, distributors, or manufacturers, but lawyers.

Consider just the costs of navigating between the *Dr. Miles* rule prohibiting resale price maintenance and the *Colgate* rule allowing firms to refuse to sell to dealers who will not follow a manufacturer's recommended resale price. The legality of a *Colgate* "announce and terminate" policy does not turn on an evaluation of its competitive effects. Rather, it turns on a formalistic inquiry into whether the supplier and dealer have engaged in verbal or nonverbal communications sufficient for them to be deemed to have entered into an agreement. Any back-and-forth communications that could give rise to an inference that the supplier asked the reseller to maintain a minimum price and that the reseller communicated his assent might suffice to find an agreement. Moreover, actions by a supplier other than immediate and indefinite termination of a noncompliant dealer raise a raft of questions whether they have "agreed" on a resale price.[25] The complexities demanded by this state of the law

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[25] Consider just these: Can a manufacturer take any retroactive action with respect to past sales, such as declining to give otherwise earned rebates or discounts or refusing to accept returns on terms otherwise applicable, or does such retroactive action permit the inference that manufacturer and dealer had agreed on resale prices and that the dealer breached the agreement? Can a manufacturer discuss with the dealer whether it will terminate the reseller, or just give the dealer a warning? Can a manufacturer adopt an "announce and terminate" policy for

force companies to spend money on legal fees that are better spent on product research and development. This type of needless line-drawing exercise is precisely what *Sylvania* sought to end by stating that any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing."[26]

II. THE ARGUMENTS OFFERED IN DEFENSE OF RETAINING A *PER SE* BAN ON MINIMUM RESALE PRICE MAINTENANCE ARE UNPERSUASIVE

In *Dr. Miles*, this Court justified a ban on resale price maintenance on the ground that the practice is an unlawful "restraint[] upon alienation."[27] Regardless of whether reliance on that ancient property law rule was appropriate in 1911,[28] that rationale did not survive this Court's 1977 decision in *Sylvania*, which rejected a rule of *per se* invalidity for vertical nonprice restraints, or the Court's 1997 decision in *Khan*,

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some products, but not for all? Can a manufacturer terminate a dealer for some elements of the manufacturer's product line, or must the dealer be terminated across the board? Can a manufacturer terminate only some noncompliant dealers, or must all be terminated? Can a manufacturer reinstate a wayward dealer, or will reinstatement be deemed an agreement to sell at the manufacturer's resale price? Can a manufacturer prohibit other dealers from transshipping goods to a terminated dealer, or will that be deemed an agreement between the manufacturer and the remaining dealers or among the remaining dealers?

[26] 433 U.S. at 58-59.

[27] 220 U.S. at 404; *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 380 (1967) (so construing *Dr. Miles*).

[28] Justice Holmes did not think so. *Dr. Miles*, 220 U.S. at 412 (dissenting opinion); *see also* Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897) ("For the rational study of the law the blackletter man may be the man of the present, but the man of the future is the man of statistics and the master of economics."); Bork, *The Antitrust Paradox* 285 ("It is hardly reassuring to learn that the sole basis for antitrust's answer to a modern business problem is the solution given three or four hundred years ago by an English judge who was talking about something else.").

which rejected a rule of *per se* invalidity for maximum resale price restraints. A defense of *Dr. Miles* must lie elsewhere.

1. *A tool to prevent cartels*: The principal defense offered today for the *Dr. Miles* rule is that minimum resale price restraints can sometimes be used as a tool to monitor and enforce horizontal cartel agreements by manufacturers or retailers. This theoretical concern, however, finds scant support, at best, in actual experience. In cases challenging horizontal cartels, evidence that vertical restraints were used as a cartel tool is rare. Similarly, cases challenging vertical restraints rarely produce evidence of horizontal cartel agreements. *Dr. Miles* may have been one of those rare exceptions; the facts in that case suggest that the dealers there may have been involved in a cartel.[29] But in the overwhelming majority of resale price maintenance cases, as in this one, there is not even a hint of horizontal cartel behavior. *See* Pet. App. 32a, 34a-35a.

In any case, the question here is not whether resale price maintenance can occasionally be anticompetitive, but whether it is virtually *always* anticompetitive.[30] There is no reason to deprive businesses and consumers of the usual benefits of the practice merely because, in unusual cases, the practice might be misused by a cartel. The Sherman Act provides ample tools to sue (and prosecute as a criminal offense) the cartel

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[29] Herbert Hovenkamp, *The Antitrust Enterprise* 186 (2005).

[30] Economists have concluded that minimum resale price maintenance can have different productive and allocative effects in different settings. *See* Carlton & Perloff, *Modern Industrial Organization* 437; William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983 (1985); F.M. Scherer, *Industrial Market Structure and Economic Performance* 591-94 (2d ed. 1980); Viscusi, Vernon & Harrington, *Economics of Regulation and Antitrust* 283 ("A detailed analysis of various cases suggests that RPM can be either efficiency increasing or decreasing, depending on the magnitude of the demand shift."). There is no serious argument, however, that this practice never or even rarely is economically beneficial.

directly; the continued application of the *per se* rule against horizontal price fixing is *not* at issue in this case. Inflexible condemnation of an often-procompetitive practice because it *might sometimes* be associated with an always-illegal practice is unwarranted. Moreover, there is widespread agreement among the antitrust bar that "[m]ost instances of resale price maintenance are beneficial to consumers and cannot reasonably be construed as efforts to restraint trade or monopolize any product or service."[31] Accordingly, the possibility that a facially legitimate business practice could be used to enforce a price-fixing agreement does not suffice to outlaw its use across the board.

2. *Congressional ratification*: Another defense is that, in 1975, Congress ratified the *Dr. Miles* rule by repealing legislation (the Miller-Tydings and McGuire Acts) authorizing states to permit resale price maintenance.[32] But that conclusion does not follow from its premise. At one time, Congress did suspend the *Dr. Miles* rule whenever a State chose to permit resale price maintenance, and Congress later lifted the suspension. But in so doing Congress did not revise the Sherman Act to incorporate the *Dr. Miles* rule and make it a permanent feature of antitrust law. The choice that Congress

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[31] Hovenkamp, *The Antitrust Enterprise* 123-24. *Accord, e.g.*, ABA Section of Antitrust Law, *Antitrust Law and Economics of Product Distribution* 76 (2006) ("the bulk of the economics literature on RPM * * * suggests that RPM is more likely to be used to enhance efficiency than for anticompetitive purposes"); Baxter, 75 CAL. L. REV. at 944-45; Blair, Herndon & Lopatka, 83 WASH. U. L.Q. at 696; Easterbrook, 53 Antitrust L.J. at 135; Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L.J. 83, 89 (1995); Ippolito, 34 J.L. & ECON. at 281-82, 292; Mathewson & Winter, 13 REV. INDUS. ORG. at 66.

[32] *See* the Miller-Tydings Act, Pub. L. No. 75-314, 50 Stat. 693 (1937), and the McGuire Act of 1952, Pub. L. No. 82-543, 66 Stat. 631 (1952), repealed by the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801.

made in 1975 was not a decision to entomb development of antitrust law in its then-current state. Rather, Congress chose to return the development of federal antitrust law to the federal common law decisionmaking process, rather than to leave the matter to state legislatures.[33] And any hope that the Members of any particular Congress may have had as to the future course of antitrust that was not expressed in positive law does not bind the courts.[34] This Court is free to revisit the issue.[35]

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[33] Bork, *The Antitrust Paradox* 288; Easterbrook, 53 Antitrust L.J. at 139; Posner, *Antitrust Law* 189.

In the 1980s, Congress twice added riders to appropriations bills prohibiting the Justice Department from arguing for reversal of the *Dr. Miles* rule. Pub. L. No. 99-180, 99 Stat. 1136 (1985); Pub. L. No. 98-166, § 510, 97 Stat. 1071, 1102 (1983); Calvani & Berg, 1984 Duke L.J. at 1166 n.11. Whatever import those restraints may have had then, they are not in effect today.

[34] *See Puerto Rico Dep't of Consumer Affairs* v. *Isla Petroleum*, 485 U.S. 495, 501 (1988) ("[U]nenacted approvals, beliefs, and desires are not law."); *Train* v. *City of New York*, 420 U.S. 35, 45 (1975) ("[L]egislative intention, without more, is not legislation.").

[35] It is no defense of the *Dr. Miles* rule that it is necessary to protect small retail firms. (In fact, it could be argued that RPM benefits small manufacturers seeking to promote a new product. Grimes, 64 Antitrust L.J. at 100; Pet. 2-3.) The antitrust laws protect the market, not individual firms whatever their size. *E.g.*, *Brooke Group, Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) ("It is axiomatic that the antitrust laws were passed for 'the protection of *competition*, not *competitors*.'") (quoting *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962)); *Volvo*, 546 U.S. 164, 126 S. Ct. at 872 & n.4 (same); *Cargill, Inc.* v. *Monfort of Colorado, Inc.*, 479 U.S. 104, 116 (1986) ("[T]he antitrust laws do not require the courts to protect small businesses from the loss of profits due to continued competition."); John H. Shenefield & Irwin M. Stelzer, *The Antitrust Laws: A Primer* 12-13 (4th ed. 2001).

III. *STARE DECISIS* CONSIDERATIONS DO NOT JUSTIFY RETAINING AN OBSOLETE, ECONOMICALLY DAMAGING RULE THAT THIS COURT WOULD NOT ADOPT TODAY

Stare decisis considerations dictate that settled decisions ordinarily should receive considerable deference and should not be abandoned lightly.[36] But those considerations enjoy less weight in this context. In the antitrust laws, Congress authorized the federal courts to create a common law governing the competitive process,[37] and the antitrust laws, like the common law generally,[38] must "adapt[] to changed circumstances and the lessons of accumulated experience."[39] Aware that "[c]ourts do make mistakes,"[40] this Court has been receptive to Justice Frankfurter's sage advice that "[w]isdom too often never comes, and so one ought not to reject it merely because it comes late."[41] In antitrust law the Court often has retraced its steps when it concluded that an earlier path was wrongly chosen.[42] That has been particularly true in

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[36] *E.g.*, *Khan*, 522 U.S. at 21.

[37] *Texas Industries, Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1981); *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 688 (1978).

[38] *See* Paul Oskar Kristeller, *"Creativity" and "Tradition,"* 44 J. HIST. IDEAS 105, 112 (1983) ("We should realize from the beginning that a completely stable or rigid tradition that never admits change is humanly impossible and has never existed.").

[39] *Khan*, 522 U.S. at 20; *Sylvania*, 433 U.S. at 48-59.

[40] *Willy* v. *Coastal Corp.*, 503 U.S. 131, 139 (1992).

[41] *Henslee* v. *Union Planters Nat'l Bank & Trust Co.*, 335 U.S. 595, 600 (1949) (Frankfurter, J., dissenting).

[42] *Compare, e.g., United States* v. *Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897) (adopting a rule of *per se* invalidity for horizontal price-fixing agreements), *with Standard Oil Co. of New Jersey* v. *United States*, 221 U.S. 1 (1911) (adopting a rule-of-reason analysis for all horizontal agreements), *with United States* v. *Trenton Potteries Co.*, 273 U.S. 392 (1927) (readopting a rule of *per se* invalidity for horizontal price-fixing agreements), *with Appalachian Coals, Inc.* v.

the case of vertical business practices, which this Court has come to appreciate as often procompetitive.[43]

United States, 288 U.S. 344 (1933) (applying a rule of reason to a horizontal output-restriction agreement), *with United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (applying a rule of *per se* invalidity for horizontal price-fixing agreements), *with Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1 (1979) (efficiency-enhancing horizontal price-fixing agreements may be subject to a rule-of-reason analysis), *with Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332 (1982) (applying a rule of *per se* invalidity for a horizontal maximum price-fixing agreement), *with NCAA* v. *Board of Regents of the Univ. of Oklahoma*, 468 U.S. 85 (1984) (applying a rule of reason to a horizontal agreement to limit output), *and with Palmer* v. *BRG of Georgia, Inc.*, 498 U.S. 46 (1990) (per curiam) (applying a rule of *per se* invalidity for a horizontal market allocation agreement). Or *compare Chicago Board of Trade* v. *United States*, 264 U.S. 231, 238 (1918) (identifying factors used in the rule-of-reason analysis), *with FTC* v. *Indiana Federation of Dentists*, 476 U.S. 447, 458-59 (1986) (articulating a so-called "quick look" analysis).

[43] *Compare, e.g., White Motor Co.* v. *United States*, 372 U.S. 253 (1963) (adopting rule-of-reason analysis for vertical nonprice restraints), *with United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (adopting a rule of *per se* invalidity for vertical nonprice restraints; overruling *White Motor*), *and with Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (abandoning a rule of *per se* invalidity for vertical nonprice restraints; overruling *Schwinn*). Or *compare Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911) (a manufacturer cannot force a distributor to agree on a manufacturer's pricing recommendation), *with United States* v. *Colgate & Co.*, 250 U.S. 300 (1919) (a manufacturer may refuse to deal with a retailer that does not honor the manufacturer's pricing recommendations), *with United States* v. *General Elec. Co.*, 272 U.S. 476 (1926) (a manufacturer can set a resale price by consigning the goods to a distributor, instead of selling them), *and with United States* v. *Parke, Davis & Co.*, 362 U.S. 29 (1960), and *Simpson* v. *Union Oil Co.*, 377 U.S. 13 (1964) (a manufacturer cannot enforce its pricing recommendations). Or *compare Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968) (adopting a rule of *per se* invalidity for maximum resale price maintenance), *with State Oil Co.* v. *Khan*, 522 U.S. 3 (1997) (rejecting

This Court had little experience with vertical restraints at the time that it decided *Dr. Miles*.[44] By outlawing the practice there, however, this Court denied itself, the lower courts, the academy, and the bar the opportunity to acquire the experience with vertical pricing mechanisms that is necessary before a business practice should invariably be outlawed.[45]

In the last 30 years, however, this Court has held that two closely related practices—vertical nonprice restraints (such as territorial restrictions) and maximum resale price maintenance—should not be deemed *per se* unlawful under the antitrust laws.[46] *Stare decisis* did not prevent this Court from overruling unsound precedents in those cases. The factors that this Court found persuasive there—particularly the economic utility of vertical restraints in promoting interbrand competition[47]—militate powerfully in favor of treating the vertical practice at issue here as another generally permissible business decision. The "lessons of accumulated experience" that this Court found convincing in *Sylvania* and *Khan* are equally instructive here.

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It is inconceivable that this Court would conclude today, as a matter of first impression, that vertical resale price

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a rule of *per se* invalidity for maximum resale price maintenance; overruling *Albrecht*).

[44] "Unlike the early cases involving horizontal restraints, none of the early vertical restraint cases wrestled with economic principle and explored the implications of the then-rudimentary learning about price theory or industrial organization." Baxter, 75 Cal. L. Rev. at 933; Hovenkamp, *The Antitrust Enterprise* 186.

[45] Hovenkamp, *The Antitrust Enterprise* 186; *see American Airlines, Inc.* v. *Wolens*, 513 U.S. 219, 234-35 (1995) ("[I]n our system of adjudication, principles seldom can be settled 'on the basis of one or two cases, but require a closer working out.'") (quoting Roscoe Pound, *Survey of the Conference Problems*, 14 U. CIN. L. REV. 324, 339 (1940) (Conference on the Status of the Rule of Judicial Precedent)).

[46] *Sylvania*, *supra*; *Khan*, *supra*.

[47] *Sylvania*, 433 U.S. at 49-52.

maintenance warrants *per se* condemnation. This case offers a perfect opportunity to revisit that issue. The Court adopted the *Dr. Miles* rule more than 90 years ago, long before it concluded that antitrust analysis should be guided by contemporary industrial organization theory. Contemporary antitrust legal and economic analysis has concluded that vertical restraints can be procompetitive. And this case squarely presents the question whether the *Dr. Miles* rule should be overruled. The *Dr. Miles* rule has become an anachronism harmful both to competition and the development of sound antitrust law. This Court should grant review in this case to reconsider and overrule the *Dr. Miles* rule automatically and invariably condemning minimum resale price maintenance.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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FILED
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SUPREME COURT, U.S.

No. 06-480

In the Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

PETITIONER

v.

PSKS, INC., D/B/A KAY'S KLOSET . . . KAY'S SHOES,

RESPONDENT

On Writ of Certiorari
to the United States Court of Appeals
For the Fifth Circuit

BRIEF OF CTIA – THE WIRELESS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE*[1]

CTIA – The Wireless Association represents all segments of the wireless communications industry. Members of CTIA include service providers, manufacturers, wireless data and Internet companies, and other industry participants. CTIA has filed *amicus* briefs in this Court and other federal courts on a variety of issues of interest to the wireless industry in such disparate cases as *Bartnicki* v. *Vopper*, 532 U.S. 514 (2001), *City of Rancho Palos Verdes* v. *Abrams*, 544 U.S. 113 (2005), and *Bell Atlantic Corp.* v. *Twombly*, No. 05-1126 (argued Nov. 27, 2006). In the present case, the Court granted CTIA's motion for leave to file a brief as *amicus curiae* at the petition stage.

Members of CTIA sell a variety of sophisticated communications products, such as Internet-accessible mobile phones, that benefit from point-of-sale consumer services. The Court's decision on the question presented here will directly affect how those companies market such devices.

SUMMARY OF ARGUMENT

I. There is a consensus among lower courts, antitrust scholars, and economists that vertical restrictions on intrabrand competition are usually procompetitive and beneficial to consumers. Such restraints are adopted for a host of legitimate, procompetitive reasons. In one fashion or another, vertical restraints are designed and operate to

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[1] All parties have consented to the filing of this brief. The parties' letters of consent have been lodged with the Clerk. Under S. Ct. R. 37.6, *amicus curiae* states that no counsel for a party has written this brief in whole or in part and that no person or entity other than the *amicus curiae*, its members, or its counsel has made a monetary contribution to the preparation or submission of this brief.

promote interbrand competition among rivals. There is no serious intellectual support for the proposition that such restrictions, or any category of such restrictions, are always or almost always anticompetitive and deserving of *per se* condemnation. Minimum resale price maintenance is one such vertical restriction.

Manufacturers, and intermediate distributors such as members of *amicus* CTIA, limit intrabrand retail price competition for legitimate and procompetitive reasons in a wide range of industries. By guaranteeing a minimum gross margin between wholesale and retail prices, a manufacturer or intermediate distributor can enlarge the number of retailers that are willing to sell the product and create and preserve retailers' incentives to invest in valuable non-price competitive behavior, such as advertising and promoting the product. Retailers' incentives to provide such costly services are severely undermined when a competitor offers lower prices without providing them and without incurring the associated costs. Manufacturers and intermediate distributors have legitimate interests in preventing this free-riding behavior, and consumers benefit from receiving the services that vertical price restraints can promote. In the absence of a cartel (not alleged in this case), manufacturers and intermediate distributors do not use minimum resale price maintenance as a device to achieve monopoly profits. Such profits require a restriction in supply, yet a vertical restriction (unless accompanied by horizontal collusion) affects only one brand; it does nothing to eliminate or reduce interbrand competition. The current *per se* treatment of minimum resale price maintenance imposes large costs on businesses and consumers alike, and produces few, if any, countervailing benefits.

II. The arguments offered in defense of retaining the *per se* rule are unpersuasive. In *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court justified a ban on resale price maintenance on the ground that the

practice is an unlawful restraint on alienation. That theory did not survive this Court's later decisions rejecting a rule of *per se* invalidity for vertical nonprice restraints and for maximum resale price restraints. *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977); *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997). This *per se* rule also is defended on the ground that it is necessary to prevent resale price maintenance from being used to enforce a manufacturer- or distributor-level price-fixing cartel. But resale price maintenance does not invariably—or even usually—stem from or lead to cartelization, resale price maintenance is not invariably anticompetitive, and the rule of reason and direct prohibitions on cartels are sufficient to police resale price maintenance for potential cartel activity. Another common defense of the *per se* rule—that one cannot be *sure* that manufacturers really have service-enhancing reasons to wish to protect their dealers' prices, and that low price rather than high service is the one thing we can be *sure* consumers desire—paternalistically substitutes scholars' and courts' beliefs about consumer preferences for the surest measure of consumer preferences, the market. That defense likewise ignores the discipline *inter*brand competition places on ineffective or mistaken manufacturer policies. Finally, some argue that Congress has endorsed the *Dr. Miles* rule. But no positive law today dictates that resale price maintenance be deemed unlawful *per se*, and the legislation used to support this congressional-acceptance argument was repealed long ago.

III. This Court has recognized that *stare decisis* has limited weight in the antitrust arena, where Congress intended that liability rules would be adjusted in light of judicial experience. That experience, coupled with the overwhelming weight of scholarship by the legal profession and economics academy, reveals that minimum resale price maintenance should not be prohibited across the board. This Court often has abandoned *per se* rules when they prove mistaken as a matter of antitrust policy. In particular, the Court has

acknowledged that vertical restraints differ materially from horizontal ones and so should not be outlawed *per se*. Few antitrust precedents have been as thoroughly discredited as *Dr. Miles*. Accordingly, *stare decisis* considerations should not dissuade the Court from abandoning a rule that is economically damaging and that the Court never would adopt if the issue arose for the first time today.

ARGUMENT

THE ANTITRUST LAWS SHOULD NOT TREAT MINIMUM RESALE PRICE MAINTENANCE AS A *PER SE* UNLAWFUL BUSINESS PRACTICE

Section 1 of the Sherman Act proscribes concerted action only if it unreasonably restrains competition. Ordinarily, courts determine whether particular conduct is anticompetitive through a case-specific application of a Rule of Reason, which requires the factfinder to assess the relevant considerations in deciding whether a practice is an unreasonable restraint on competition.[2] Certain practices, however, are deemed *per se* illegal, dispensing with the need for case-by-case evaluation. But since *per se* rules of illegality condemn practices without even asking if they promote competition in a particular setting, they create a risk of falsely condemning procompetitive conduct.[3] Accordingly, *per se* rules of illegality are appropriate only for "conduct that is manifestly anticompetitive."[4] Proponents of any such rule have the burden of proving, "based upon demonstrable economic effect,"[5] that it is "'immediately obvious'" or known through

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[2] *See, e.g., Texaco, Inc.* v. *Dagher*, 547 U.S. 1, 126 S. Ct. 1276, 1279 (2006); *Sylvania*, 433 U.S. at 49; *Chicago Board of Trade* v. *United States*, 246 U.S. 231, 238 (1918); *Standard Oil Co.* v. *United States*, 221 U.S. 1, 60 (1911).

[3] *See Polygram Holding, Inc.* v. *FTC*, 416 F.3d 29, 34 (D.C. Cir. 2005) (Ginsburg, C.J.).

[4] *Sylvania*, 433 U.S. at 49.

[5] *Sylvania*, 433 U.S. at 58-59.

"'experience'"[6] that a practice has "a pernicious effect on competition and lack[s] * * * any redeeming virtue"[7] because it "'would always or almost always tend to restrict competition and decrease output.'"[8] A particular business practice therefore should be held *per se* unlawful only when "'experience'" with it will "'[e]nable the Court to predict with confidence that the rule of reason will condemn it.'"[9]

Under that approach, minimum resale price maintenance should not be deemed unlawful *per se* for three reasons:

First: Resale price maintenance directly and ordinarily serves legitimate, procompetitive goals. Among other things, the practice is used to create incentives for retailers to engage in point-of-sale product advertising and promotion, to maintain adequate inventory, and to train sales personnel to explain new, complex, or technical products. Manufacturers and intermediate distributors could reasonably believe that resale price maintenance is necessary to prevent some retailers from free riding off the presale services supplied by others, and market forces will provide the necessary discipline if they are wrong, because inefficient practices will result in loss of sales to *interbrand* competitors.

Second: The rationale for a rule of *per se* illegality has become obsolete over time. The Court adopted that rule in 1911 in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*[10] before it had experience with vertical restraints. Since then, the Court has rejected *per se* rules in closely analogous

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[6] *Khan*, 522 U.S. at 10 (quoting *Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332, 344 (1982)).

[7] *Northern Pacific Ry.* v. *United States*, 356 U.S. 1, 5 (1958).

[8] *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985) (quoting *Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1, 19-20 (1979)); *Khan*, 522 U.S. at 10.

[9] *Khan*, 522 U.S. at 10 (quoting *Maricopa*, 457 U.S. at 344).

[10] 220 U.S. 373.

circumstances.[11] Moreover, resale price maintenance also is not so inherently likely to serve as a façade or tool for price fixing that it should be condemned without giving a party a chance to defend its use. The Justice Department has ample tools to investigate horizontal cartels, and the Rule of Reason is fully satisfactory to review specific vertical practices. Accordingly, the substantive antitrust rules governing vertical restraints need not be manipulated in order to deal with the problem of horizontal restraints. Finally, no Act of Congress dictates the result in this case. At one time, Congress lifted the *per se* ban on resale price maintenance when permitted by state law, and later it repealed that law. But Congress has never amended the Sherman Act to incorporate the *Dr. Miles* rule.

Third: *Stare decisis* considerations do not justify retention of the *Dr. Miles* rule. This Court adopted that rule nearly 100 years ago, long before it acquired experience with the pro-competitive benefits of vertical restraints; the Court often has recognized that Congress intended it to adjust federal antitrust jurisprudence in light of contemporary wisdom and experience; and this Court has done precisely that in the closely related areas of vertical nonprice restraints by abandoning outdated rules that treated such practices as *per se* illegal. *Stare decisis* considerations therefore do not dictate retention of a competitively damaging rule that this Court would not adopt today in the first instance.

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[11] *State Oil* v. *Khan*, 522 U.S. 3 (1997) (rejecting a *per se* rule of illegality for maximum resale price maintenance); *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977) (rejecting a *per se* rule of illegality for nonprice vertical restraints); *cf. Illinois Tool Works* v. *Independent Ink, Inc.*, 547 U.S. ___, 126 S. Ct. 1281 (2006) (rejecting a *per se* rule that a patent creates monopoly power).

I. MINIMUM RESALE PRICE MAINTENANCE COMMONLY SERVES LEGITIMATE, PROCOMPETITIVE PURPOSES AND SHOULD NOT BE OUTLAWED ACROSS THE BOARD

A. Manufacturers and intermediate distributors use vertical restraints for a host of legitimate, procompetitive reasons. In one fashion or another, vertical restraints are designed and operate to promote interbrand competition among rivals by restraining intrabrand competition among multiple dealers offering the same product. Over the last 30 years, this Court has recognized on a number of occasions that vertical restraints can be procompetitive.[12]

Minimum resale price maintenance (also known as RPM) is one type of vertical restraint. Sometimes used in lieu of vertical integration, minimum resale price maintenance constrains the lowest price at which a dealer can offer a supplier's product.[13] Although this Court banned that practice in 1911 in the *Dr. Miles* case, for more than two decades there has been widespread agreement among antitrust scholars[14]

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[12] *See Sylvania*, 433 U.S. at 54 ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 762-763 (1984); *Business Electronics Corp.* v. *Sharp Electronics Corp.*, 485 U.S. 717, 728 (1988); *Khan*, 522 U.S. at 15-19.

[13] A vertically integrated firm would set its own resale price to consumers, so resale price maintenance is a partial substitute for vertical integration. Roger D. Blair & David L. Kaserman, *Antitrust Economics* 353 (1985).

[14] *See, e.g.*, 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1611 (2d ed. 2004); Robert H. Bork, *The Antitrust Paradox* 280-98 (1993 ed.); William F. Baxter, *The Viability of the Vertical Restraints Doctrine*, 75 CAL. L. REV. 933, 935 (1987); Terry Calvani & Andrew G. Berg, *Resale Price Maintenance After* Monsanto*: A Policy Still at War With Itself*, 1984 DUKE L.J. 1163, 1180-82; Frank Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 146-48

and economists[15] alike that minimum resale price maintenance is a legitimate business practice that manufacturers

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(1984); Herbert Hovenkamp, *The Antitrust Enterprise* 123-24, 186-91 (2005); Timothy J. Muris, *Improving the Economic Foundations of Competition Policy*, 12 GEO. MASON L. REV. 1, 17 (2003); Richard A. Posner, *Antitrust Law* 172-73, 189 (2d ed. 2001). *But see* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487 (1983).

[15] *See, e.g.*, Roger D. Blair, Jill Boylston Herndon & John E. Lopatka, *Resale Price Maintenance and the Private Antitrust Plaintiff*, 83 WASH. U.L.Q. 657, 659, 697-714 (2005); David A. Butz, *Vertical Price Controls With Uncertain Demand*, 40 J.L. & ECON. 433 (1997); Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 423-34 (4th ed. 2005); Yongmin Chen, *Oligopoly Price Discrimination and Resale Price Maintenance*, 30 RAND J. ECON. 441 (1999); James Cooper, *et al.*, *Vertical Restraints and Antitrust Policy: What About the Evidence?*, 1 COMPETITION POL. INT'L 45, 55-58 (2005); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 AMER. ECON. REV. 619 (1997); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. ECON. 885 (1996); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991); Benjamin Klein, *The Economics of Franchise Contracts*, 2 J. CORP. FIN. 9 (1995); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265 (1988); Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 REV. INDUS. ORG. 57 (1998); Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. POL. ECON. 1074 (1986); Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & ECON. 363 (1985); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 RAND J. ECON. 346 (1984); Thomas R. Overstreet, Jr., Bureau of Econ., Fed'l Trade Comm'n, *Resale Price Maintenance: Economic Theories and Empirical Evidence* (Staff Report 1983); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960); Jean Tirole, *The Theory of Industrial Organization* 170-84 (1988); W. Kip Viscusi, John M. Vernon & Joseph E.

ordinarily use as a means of limiting *intra*brand competition in order to enhance *inter*brand competition, which is the "primary concern of antitrust law."[16]

Minimum resale price maintenance fosters competition and efficiency in many ways. By ensuring a minimum margin between wholesale and retail prices, a manufacturer or intermediate distributor can: (1) ensure that a larger number of retail outlets will carry the product; (2) spur nonprice competition among potential dealers for the right to sell the product; (3) create loyalty and honesty in retailers; (4) prevent deterioration in the image of quality or prestige created by the manufacturer's or intermediate distributor's marketing efforts; and (5) create and preserve retailers' incentives to invest in several forms of valuable non-price competitive behavior. Examples of such procompetitive non-price behavior include, among others: point-of-sale advertising and product promotion to educate consumers about new or complex products; adequate, well-organized inventory and prominent shelf space in individual outlets; the hiring or training of knowledgeable sales personnel to explain products; creation of an attractive shopping environment (*e.g.*, multiple, short cashier lines, and convenient, usable product samples); and the offer of after-sale services. A manufacturer's economic encouragement of these behaviors can cause retailers to create nonprice value for consumers that exceeds the value of a somewhat lower retail price, and therefore enhances demand for the product.

Efforts by manufacturers or intermediate distributors to offer consumers point-of-sale services are common in a wide range of industries. Consumers benefit directly from receiving

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Harrington, Jr., *Economics of Regulation and Antitrust* 283 (4th ed. 2005); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. ECON. 61 (1993).

[16] *Sylvania*, 433 U.S. at 52 n.19; *see also Volvo Trucks North America, Inc.* v. *Reeder-Simco GMC, Inc.*, 546 U.S. 164, 126 S. Ct. 860, 872 (2006).

the services and indirectly from the augmented interbrand competition. And even dealers can benefit financially from increased consumer demand due to nonprice sales features. In sum, all parties can benefit from this practice.[17]

Retailers' incentives to provide costly point-of-sale services are severely undermined when a retailer that provides these services loses sales to a competitor that can offer lower prices because it does not provide such services and therefore does not incur the costs associated with them. A manufacturer or intermediate distributor has legitimate interests in preventing this kind of free-riding behavior, to encourage the provision of these retail services when they allow the manufacturer to engage more effectively in interbrand competition. Yet, without a minimum resale price, dealers knowledgeable or fearful of free-riding competitors would not offer these services, injuring the manufacturer and consumers alike.

The dramatic growth of Internet commerce has vastly increased the threat of free riding; retailers that provide costly point-of-sale services now lose sales to distant Internet sellers, not just local bricks-and-mortar free riders. If RPM were permissible, manufacturers or intermediate distributors could use that device to distribute their products through the Internet, while limiting free riding by Internet sellers. Instead, because RPM is currently *per se* illegal, manufacturers and intermediate distributors now face the

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[17] Manufacturers vary in their use of resale price maintenance. Some firms may find it useful for retailers to educate consumers about new products or about old ones that are purchased infrequently, such as electronics equipment or vehicles. Other companies may find it valuable to use RPM in lieu of or in conjunction with national advertising. Different manufacturers may abandon RPM over time as consumers gain familiarity with a product. And still other manufacturers may choose to rely entirely on national advertising for consumer education. Telser, 3 J.L. & ECON. at 95-96; Blair & Kaserman, *Antitrust Economics* 350; Mathewson & Winter, 13 REV. INDUS. ORG. at 68.

unattractive alternatives of forgoing Internet distribution entirely, or severely undermining the incentives of their bricks-and-mortar retailers to provide valuable point-of-sale services.

In the absence of a cartel, manufacturers and intermediate distributors do not use minimum resale price maintenance as a device to achieve monopoly profits. Such profits require a restriction in supply, yet a single manufacturer's vertical restriction affects only one brand; it does nothing to eliminate or reduce interbrand competition. It also would be irrational for a manufacturer to use resale price maintenance to allow distributors to earn a monopoly return; that would be tantamount to giving money to distributors. And if all that a manufacturer wanted were to increase prices, it would simply raise the price charged to distributors.[18]

A manufacturer may sometimes misgauge consumer preferences, and a particular decision to promote non-price competition by suppressing intrabrand price competition could conceivably make consumers, on the whole, worse off. The reason, however, is not that the manufacturer has done something anticompetitive, and the reasonable response to this phenomenon is not strict treble-damage liability for

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[18] The same principles apply even when the manufacturer is the dominant firm in an industry. Minimum resale price maintenance does not enable a dominant firm to extract monopoly profits from consumers. If a manufacturer is a monopolist, it can make pricing decisions without need for this restraint, since the exercise of its market power is not itself illegal. Hovenkamp, *The Antitrust Enterprise* 291 (there is no "no-fault" antimonopoly rule); *e.g.*, *Berkey Photo, Inc.* v. *Eastman Kodak Co.*, 603 F.2d 263, 294 (2d Cir. 1979); *Blue Cross & Blue Shield United of Wisconsin* v. *Marshfield Clinic*, 65 F.3d 1406, 1412-13 (7th Cir. 1995) (Posner, C.J.); *Alaska Airlines, Inc.* v. *United Airlines, Inc.*, 948 F.2d 536, 548-49 (9th Cir. 1991); *Williamsburg Wax Museum, Inc.* v. *Historic Figures, Inc.*, 810 F.2d 243, 252 (D.C. Cir. 1987); *Kartell* v. *Blue Shield of Massachusetts*, 749 F.2d 922, 927 (1st Cir. 1984); *Trace X Chem., Inc.* v. *Canadian Indus., Ltd.*, 738 F.2d 261, 268 (8th Cir. 1984).

guessing wrong. Because sellers of products can be more profitable by giving consumers what they want than what they do not want, the incentive of the manufacturer is aligned with that of the body of consumers, and a misapprehension of consumers' tradeoffs is merely the result of imperfect information or bad business judgment, not a diminution in competition. Moreover, *inter*brand rivals can take advantage of such a mistake by offering consumers the cheaper, no-frills product if that is what consumers (in the requisite numbers) want. The market, not a court, will "punish" the manufacturer for any mistakes it makes.[19] And here the record facts suggest that petitioner did *not* make any mistake, but rather correctly chose a strategy to advance both its own business interests and consumer welfare. *See* Pet. App. 37a-38a. The self-correcting "problem" of manufacturer restraints that do not in practice optimize consumer welfare for some limited period of time is trivial in comparison to the procompetitive benefits of resale price maintenance, and certainly no reason for a *per se* rule against the practice.

Moreover, were RPM not categorically forbidden, it would be relatively easy to identify those cases in which a firm's RPM policy produces a net decrease in consumer welfare by providing services that consumers do not value enough to justify paying higher prices. As Judge Posner has explained, a determination whether consumers have benefited is precisely equivalent to a determination whether the vertical restraint caused the output of the firm imposing the restraint to rise or fall. "If its output expanded, the restriction must have made the firm's product more attractive to consumers on balance, thereby enabling the firm to take business from its competitors. * * * The increase [in interbrand competition] *must* exceed any net reduction in intrabrand competition considered in both its price and service aspects. * * * If, on balance, the product is more attractive to consumers, as

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[19] *See* 8 Areeda & Hovenkamp, *supra*, ¶ 1612e, at 149.

demonstrated by the fact that more of it is sold, the net effect on competition must be positive."[20]

Thus, perversely, the instances of RPM most likely to be corrected by the market itself (because they are unprofitable) are the only ones that (in the absence of a cartel) might even possibly reduce overall consumer welfare and therefore be of conceivable antitrust concern. The instances of RPM most likely to be attacked in litigation—sustained, *successful* efforts by a manufacturer to increase its output and improve its brand image and profitability—are those most clearly beneficial to consumers.

B. This Court has acknowledged that every other means through which manufacturers may limit intrabrand competition can be procompetitive. A manufacturer may lawfully limit intrabrand competition by vertically integrating into retailing;[21] by announcing a suggested retail price and unilaterally terminating any retailer that charges less;[22] by contractually limiting the geographic area or the class of customers that a retailer may serve;[23] and by agreeing with retailers on a maximum retail price.[24] Like resale price maintenance, all of these practices have both the purpose and the effect of limiting intrabrand competition, but this Court has recognized that such practices often increase interbrand competition. Their net effect is usually procompetitive, and none of these practices is subject to *per se* condemnation; indeed, the vertical restriction that is the most similar to resale

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[20] Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 21 (1981) (emphasis in original).

[21] *See United States* v. *Addyston Pipe & Steel Co.*, 85 F. 271, 287 (6th Cir. 1898) (Taft, J.), *aff'd as modified*, 175 U.S. 211 (1899); *cf. United States* v. *United States Steel Corp.*, 251 U.S. 417 (1920).

[22] *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919); *Monsanto*, *supra*; *Sharp Electronics*, *supra*.

[23] *Sylvania*, *supra*.

[24] *Khan*, *supra*.

price maintenance—a manufacturer's unilateral policy of refusing to sell to any dealer than charges less than the price "suggested" by the manufacturer—is *per se lawful*.

Judicial experience has confirmed that vertical restraints are almost always procompetitive. When non-price vertical restraints were mistakenly treated as *per se* unlawful, the result was described by Judge Ginsburg (formerly the Assistant Attorney General in charge of the Antitrust Division) as a "plaintiffs' picnic" that produced a surge of meritless antitrust litigation.[25] *Sylvania* corrected that mistake by holding that the legality of non-price vertical restraints must be judged by their actual competitive effects; in the 14 years after *Sylvania* was decided, plaintiffs won in only four of the 45 reported decisions involving non-price vertical restraints.[26] And that sample of 45 litigated cases, of course, involved those restraints that were *most* likely to be anticompetitive. For the vast majority of vertical restraints, no plaintiff even *alleged* an anticompetitive effect. In light of this judicial experience with non-price vertical restraints, there is no reason to believe that resale price maintenance is virtually always anticompetitive. Vertical agreements that limit intrabrand price competition should be treated in the same way as non-price vertical restraints.

Instead, under the *Dr. Miles* rule, businesses are forced to use more costly and less effective devices to limit intrabrand competition rather than resale price maintenance agreements, and to spend large amounts of time and money on antitrust compliance programs designed to ensure adherence to arbitrary distinctions that are as irrational and counterintuitive to business executives as they are to antitrust scholars. These costs are imposed on every manufacturer or intermediate distributor that relies on others to distribute and retail its

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[25] Douglas H. Ginsburg & Leah Brannon, *Determinants of Private Antitrust Enforcement in the United States*, 1 COMPETITION POLICY INT'L 29, 37 (2005).

[26] *Id.* at 42.

products. And the beneficiaries of this complexity are not consumers, distributors, or manufacturers, but lawyers.[27]

Consider just the costs of navigating between the *Dr. Miles* rule prohibiting resale price maintenance and the *Colgate* rule allowing firms to refuse to sell to dealers who will not follow a manufacturer's recommended resale price. The legality of a *Colgate* "announce and terminate" policy does not turn on an evaluation of its competitive effects. Rather, it turns on a formalistic inquiry into whether the supplier and dealer have engaged in verbal or nonverbal communications sufficient for them to be deemed to have entered into an agreement. Any back-and-forth communications that could give rise to an inference that the supplier asked the reseller to maintain a minimum price and that the reseller communicated his assent might suffice to allow a finding of agreement. Moreover, actions by a supplier other than immediate and indefinite termination of a noncompliant dealer raise a raft of questions whether they have "agreed" on a resale price. Here are just a few examples:

- Can a manufacturer take any retroactive action with respect to past sales, such as declining to give otherwise earned rebates or discounts or refusing to accept returns on terms otherwise applicable, or does such retroactive action permit the inference that manufacturer and dealer had agreed on resale prices and that the dealer breached the agreement?
- Can a manufacturer discuss with the dealer whether it will terminate the reseller, or just give the dealer a warning?
- Can a manufacturer adopt an "announce and terminate" policy for some products, but not for all?

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[27] *See* Posner, 48 U. CHI. L. REV. at 14 ("The Court's distinction between price and nonprice restrictions has no intuitive meaning to the businessman, and makes his fortunes ever more dependent on whether he, his dealers, and his distributors, have good antitrust lawyers.").

- Can a manufacturer terminate a dealer for some elements of the manufacturer's product line, or must the dealer be terminated across the board?
- Can a manufacturer terminate only some noncompliant dealers, or must all be terminated?
- Can a manufacturer reinstate a wayward dealer, or will reinstatement be deemed an agreement to sell at the manufacturer's resale price?
- Can a manufacturer prohibit other dealers from transshipping goods to a terminated dealer, or will that be deemed an agreement between the manufacturer and the remaining dealers or among the remaining dealers to sell at the manufacturer's resale price?

The complexities demanded by this state of the law force companies to spend on legal fees money that is better spent on product research and development. This type of needless line-drawing exercise is precisely what *Sylvania* sought to end by stating that any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing."[28] And a distinction between "price" and "nonprice" vertical restraints, though encouraged by dictum in *Sylvania* itself,[29] is just such formalistic line drawing. "This distinction between price and nonprice restrictions is indefensible."[30]

II. THE ARGUMENTS OFFERED IN DEFENSE OF RETAINING A *PER SE* BAN ON MINIMUM RESALE PRICE MAINTENANCE ARE UNPERSUASIVE

In *Dr. Miles*, this Court justified a ban on resale price maintenance on the ground that the practice is an unlawful "restraint[] upon alienation."[31] Regardless of whether reliance

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[28] 433 U.S. at 58-59.

[29] 433 U.S. at 51 n.18.

[30] Posner, 48 U. CHI. L. REV. at 9.

[31] 220 U.S. at 404; *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365, 380 (1967) (so construing *Dr. Miles*).

on that ancient property law rule was appropriate in 1911,[32] that rationale did not survive this Court's 1977 decision in *Sylvania*, which rejected a rule of *per se* invalidity for vertical nonprice restraints, or the Court's 1997 decision in *Khan*, which rejected a rule of *per se* invalidity for maximum resale price restraints. A defense of *Dr. Miles* must lie elsewhere.

A. A tool to prevent cartels: The principal defense offered today for the *Dr. Miles* rule is that minimum resale price restraints can sometimes be used as a tool to monitor and enforce horizontal cartel agreements by manufacturers or retailers. That theoretical concern, however, finds scant support, at best, in actual experience. In cases challenging horizontal cartels, evidence that vertical restraints were used as a cartel tool is rare. Similarly, cases challenging vertical restraints rarely produce evidence of horizontal cartel agreements. *Dr. Miles* may have been one of those rare exceptions; the facts in that case suggest that the dealers there may have been involved in a cartel.[33] But in the overwhelming majority of resale price maintenance cases, as in this one, there is not even a hint of horizontal cartel behavior. *See* Pet. App. 32a, 34a-35a.

The leading scholarly defender of the *per se* rule against RPM has rested his analysis largely on the possibility of cartel facilitation. Dean Pitofsky has asserted that "experience shows that the manufacturer is often induced to act as an organizer of [a] dealer's cartel by dealer threats or

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[32] Justice Holmes did not think so. *Dr. Miles*, 220 U.S. at 412 (dissenting opinion); *see also* Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 469 (1897) ("For the rational study of the law the blackletter man may be the man of the present, but the man of the future is the man of statistics and the master of economics."); Bork, *The Antitrust Paradox* 285 ("It is hardly reassuring to learn that the sole basis for antitrust's answer to a modern business problem is the solution given three or four hundred years ago by an English judge who was talking about something else.").

[33] Herbert Hovenkamp, *The Antitrust Enterprise* 186 (2005).

enticements," and noted that through RPM "the manufacturer *may* tend to stabilize prices at the *manufacturer's* level."[34] From those premises, he leaps to the conclusion that "vertical price fixing *almost always* generates anticompetitive horizontal effects at the dealer level, and sometimes at the manufacturer level as well."[35]

Experience, however, simply does not show what Dean Pitofsky claimed. For the proposition that the use of RPM to facilitate dealer cartels was frequent, he cited only a decision of this Court and a law review article,[36] neither of which purports to support any proposition stronger than the point that RPM *can* be used to facilitate a dealer cartel.[37] For the proposition that RPM *may* facilitate manufacturer cartels, he made no claim about what experience shows. Actual empirical research attempting to address the question whether

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[34] Pitofsky, 71 GEO. L.J. at 1490 (first emphasis added).

[35] Pitofsky, 71 GEO. L.J. at 1491 (emphasis added).

[36] *United States* v. *General Motors Corp.*, 384 U.S. 127, 145-147 (1966); Ward Bowman, *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. CHI. L. REV. 825, 830-831 (1955), *cited in* Pitofsky, 71 GEO. L.J. at 1490 n.19.

[37] Professor Bowman did *assert* that "examples" he had discussed—involving U.S. druggists' pressure on wholesalers between 1900 and 1904, similar pressure in the same industry in Great Britain between 1895 and 1906, and similar activities in the same industry in France between 1886 and 1933—"suggest that resale price maintenance is a method used by organized dealers to force unwilling manufacturers to work for them to protect dealer profit margins." 22 U. CHI. L. REV. at 830. He further asserted that this "simple, plausible explanation of resale price maintenance * * * *probably* explains *much* of its recent as well as its early use." *Id.* at 831 (emphasis added). But he provided no stronger empirical support than turn-of-the-century evidence from one industry in three countries, and he acknowledged elsewhere in the same article that "a great many manufacturers actively support resale price maintenance, even though their dealers are not organized to present the kind of united front found among drug and liquor dealers." *Id.* at 833 (footnote omitted); see also *id.* at 840-841 & nn.46-48.

RPM *is* used to facilitate cartels, by contrast, has concluded that such use is infrequent.[38]

In any case, the question here is not whether resale price maintenance can occasionally be anticompetitive, but whether it is virtually *always* anticompetitive. There is no reason to deprive businesses and consumers of the usual benefits of the practice merely because, in unusual cases, the practice might be misused by a cartel.

The continued application of the *per se* rule against horizontal price fixing is *not* at issue in this case. The Justice Department has wide-ranging authority to investigate suspected cartel activity by using grand jury subpoenas and Civil Investigative Demands, and, by offering leniency to individual and corporate whistleblowers, offers a powerful incentive to participating cartel members to identify anticompetitive activity.[39] And the Sherman Act provides ample tools to sue (and prosecute as a criminal offense) a cartel directly. Inflexible condemnation of an often-procompetitive practice because it *might sometimes* be associated with an always-illegal practice is unwarranted. Moreover, there is widespread agreement among the antitrust

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[38] Ippolito, 34 J.L. & ECON. at 281 (concluding that "there is little [empirical] evidence * * * to support the hypothes[is] * * * that collusion is the primary reason for the use of RPM"); *id.* at 282 (the evidence "suggests that noncollusive uses of RPM are far more common than collusive uses"); *id.* at 291-292 ("service- and sales-enhancing theories, taken together, appear to have greater potential to explain" observed uses of RPM than a collusion hypothesis); *id.* at 292 ("The evidence suggests that the collusion theories do not seem capable of explaining at least 85 percent of the cases, and, when taken together, the agency theories are plausible explanations for virtually all cases in the sample.").

[39] *See* U.S. Department of Justice, Antitrust Division, *Leniency Policy for Individuals* (Aug. 10, 2004), at http://www.usdoj.gov/atr/public/guidelines/0092.htm; U.S. Department of Justice, Antitrust Division, *Corporate Leniency Policy* (Aug. 10, 2003), at http://www.usdoj.gov/atr/public/guidelines/0091.htm.

bar that "[m]ost instances of resale price maintenance are beneficial to consumers and cannot reasonably be construed as efforts to restraint trade or monopolize any product or service."[40] Accordingly, the possibility that a facially legitimate business practice could be used to enforce a price-fixing agreement does not suffice to outlaw its use across the board.

B. Low price as the exclusive or nearly exclusive measure of consumer welfare: Another argument made in defense of the *per se* rule against RPM is that low price is so central a measure of consumer welfare that any practice that raises prices to consumers should be presumed—conclusively or nearly so—to harm consumer welfare. Advocates of this view belittle service competition, question how often manufacturers really use RPM to encourage dealers to provide better service, and suggest that they themselves know better than consumers what mix of low price and high service consumers want.

Dean Pitofsky, for instance, gives the hypothetical example of a manufacturer that sells its highly advertised product at a wholesale price of $20, after which the product can be found in some fashionable stores at a retail price of $35 but in discount houses at $22. Ignoring interbrand competition entirely, he asserts that the competition between the fashionable stores and the discount houses will force the retail prices in the fashionable stores to fall, and eventually

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[40] Hovenkamp, *The Antitrust Enterprise* 123-24. *Accord, e.g.*, ABA Section of Antitrust Law, *Antitrust Law and Economics of Product Distribution* 76 (2006) ("the bulk of the economics literature on RPM * * * suggests that RPM is more likely to be used to enhance efficiency than for anticompetitive purposes"); Baxter, 75 CAL. L. REV. at 944-45; Blair, Herndon & Lopatka, 83 WASH. U. L.Q. at 696; Easterbrook, 53 ANTITRUST L.J. at 135; Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 ANTITRUST L.J. 83, 89 (1995); Ippolito, 34 J.L. & ECON. at 281-82, 292; Mathewson & Winter, 13 REV. INDUS. ORG. at 66.

force the manufacturer to cut its wholesale price.[41] In Dean Pitofsky's eyes, it seems to be self-evident that consumers benefit from this process.

To ignore interbrand competition, however, is to distort the analysis in quite a major way. If low price alone is what consumers perceive as maximizing their welfare, the manufacturer that uses RPM to maintain a uniform retail price of $35 will create a golden opportunity for a *rival manufacturer* to take sales away from the first manufacturer by allowing its dealers to charge a $22 retail price for an equivalent product. If interbrand competition does *not* take away enough sales from the first manufacturer to force it to lower its price, it must be because consumers perceive the first manufacturer's product—and the services that accompany its sale—to justify paying more money. Consumers *necessarily* have concluded, in sufficient numbers to make a $35 retail price profit maximizing, that they *prefer* the higher-priced good to the lower-priced good. It is a strange conception of consumer welfare that refuses to honor that choice by consumers. And it is, if anything, even stranger to assume that *intra*brand competition by retailers will force manufacturers to cut prices while assuming that *inter*brand competition has had and will have no such effect.

Relatedly, Dean Pitofsky defends discounters as "the very heart of a free market competitive system," worries that they will be "den[ied] * * * access to products because they are aggressive in pricing (and perhaps more efficient as well)," and suggests that to allow RPM is giving "the manufacturer, in effect, * * * the power to put" no-frills discounters "out of business."[42] Only by again ignoring interbrand competition, however, and by treating as *a priori* incredible the proposition that consumers may in some circumstances *prefer* higher-

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[41] Pitofsky, 71 GEO. L.J. at 1492.
[42] Pitofsky, 71 GEO. L.J. at 1493.

priced goods, can Dean Pitofsky make those worries seem so serious.

If consumers truly would rather purchase goods from no-frills discounters, rivals of the manufacturer that refuses to allow discounters to carry its goods will clobber that manufacturer in the marketplace. The issue is not one of putting no-frills discounters out of business, but one of allowing different manufacturers to compete using different strategies, including a low-price, no-frills retail strategy and a high-price, high-service "luxury goods" retail strategy. Although Dean Pitofsky asserts that "[t]hose opposing *per se* rules in this area implicitly assume that the manufacturer knows better than the market what will or will not work in the marketplace,"[43] the exact opposite is actually the case. Those opposing *per se* rules in this area are completely agnostic about what will or will not work in the marketplace, but have confidence in the market itself to punish sellers who are wrong about what will work, in particular sellers who wrongly assume that a high-price, high-service mix will appeal to consumers and sellers who wrongly assume that their RPM policies will induce better service by dealers. Those advocating *per se* rules in this area are confident in their views that low price is always what consumers prefer, and unwilling to let consumers express their real preferences through the market. Instead, they use a rigid legal rule to force *every* manufacturer and intermediate distributor, except those vertically integrated to the retail level, to allow retail discounting of its product in all circumstances. It is the defenders of the *per se* rule, not its critics, who lack "[a] full commitment to a regime whereby competition governs the marketplace."[44]

C. Congressional ratification: Another defense is that, in 1975, Congress ratified the *Dr. Miles* rule by repealing

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[43] Pitofsky, 71 GEO. L.J. at 1493.
[44] Pitofsky, 71 GEO. L.J. at 1493.

legislation (the Miller-Tydings and McGuire Acts) authorizing states to permit resale price maintenance.[45] But that conclusion does not follow from its premise. At one time, Congress did suspend the *Dr. Miles* rule whenever a State chose to permit resale price maintenance, and Congress later lifted the suspension. But in so doing Congress did not revise the Sherman Act to incorporate the *Dr. Miles* rule and make it a permanent feature of antitrust law. The choice that Congress made in 1975 was not a decision to entomb development of antitrust law in its then-current state. Rather, Congress chose to return the development of federal antitrust law to the federal common law decisionmaking process, rather than to leave the matter to state legislatures.[46] And any hope that the Members of any particular Congress may have had as to the future course of antitrust that was not expressed in positive law does not bind the courts.[47] This Court is free to revisit the issue.[48]

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[45] *See* the Miller-Tydings Act, Pub. L. No. 75-314, 50 Stat. 693 (1937), and the McGuire Act of 1952, Pub. L. No. 82-543, 66 Stat. 631 (1952), repealed by the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801.

[46] Bork, *The Antitrust Paradox* 288; Easterbrook, 53 Antitrust L.J. at 139; Posner, *Antitrust Law* 189.

In the 1980s, Congress twice added riders to appropriations bills prohibiting the Justice Department from arguing for reversal of the *Dr. Miles* rule. Pub. L. No. 99-180, 99 Stat. 1136 (1985); Pub. L. No. 98-166, § 510, 97 Stat. 1071, 1102 (1983); Calvani & Berg, 1984 DUKE L.J. at 1166 n.11. Even then, however, Congress did not limit private litigants' ability to challenge *Dr. Miles* or the Court's authority to reconsider its *per se* rule. Whatever import those appropriations bills may have had then, they are not in effect today.

[47] *See Puerto Rico Dep't of Consumer Affairs* v. *Isla Petroleum*, 485 U.S. 495, 501 (1988) ("[U]nenacted approvals, beliefs, and desires are not law."); *Train* v. *City of New York*, 420 U.S. 35, 45 (1975) ("[L]egislative intention, without more, is not legislation.").

[48] It is no defense of the *Dr. Miles* rule that it is necessary to protect small retail firms. (In fact, it could be argued that RPM benefits small manufacturers seeking to promote a new product, Grimes, 64

III. *STARE DECISIS* CONSIDERATIONS DO NOT JUSTIFY RETAINING AN OBSOLETE, ECONOMICALLY DAMAGING RULE THAT THIS COURT WOULD NOT ADOPT TODAY

Stare decisis considerations dictate that settled decisions ordinarily should receive considerable deference and should not be abandoned lightly.[49] But those considerations enjoy less weight in this context. In the antitrust laws, Congress authorized the federal courts to create a common law governing the competitive process,[50] and the antitrust laws, like the common law generally,[51] must "adapt[] to changed circumstances and the lessons of accumulated experience."[52] Aware that "[c]ourts do make mistakes,"[53] this Court has been receptive to Justice Frankfurter's sage advice that "[w]isdom too often never comes, and so one ought not to reject it

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ANTITRUST L.J. at 100; Pet. 2-3, and small retailers wishing to provide services without the threat of free riding by others, Pet. App. 52a & n.46.) The antitrust laws protect the market, not individual firms whatever their size. *E.g.*, *Brooke Group, Ltd.* v. *Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 224 (1993) ("It is axiomatic that the antitrust laws were passed for 'the protection of *competition*, not *competitors*.'") (quoting *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 320 (1962)); *Volvo*, 546 U.S. 164, 126 S. Ct. at 872 & n.4 (same); *Cargill, Inc.* v. *Monfort of Colorado, Inc.*, 479 U.S. 104, 116 (1986) ("[T]he antitrust laws do not require the courts to protect small businesses from the loss of profits due to continued competition."); John H. Shenefield & Irwin M. Stelzer, *The Antitrust Laws: A Primer* 12-13 (4th ed. 2001).

[49] *E.g.*, *Khan*, 522 U.S. at 21.

[50] *Texas Industries, Inc.* v. *Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1981); *National Society of Professional Engineers* v. *United States*, 435 U.S. 679, 688 (1978).

[51] *See* Paul Oskar Kristeller, *"Creativity" and "Tradition,"* 44 J. HIST. IDEAS 105, 112 (1983) ("We should realize from the beginning that a completely stable or rigid tradition that never admits change is humanly impossible and has never existed.").

[52] *Khan*, 522 U.S. at 20; *Sylvania*, 433 U.S. at 48-59.

[53] *Willy* v. *Coastal Corp.*, 503 U.S. 131, 139 (1992).

merely because it comes late."[54] In antitrust law the Court often has retraced its steps when it concluded that an earlier path was wrongly chosen.[55] That has been particularly true in the case of vertical business practices, which this Court has come to appreciate as often procompetitive.[56]

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[54] *Henslee* v. *Union Planters Nat'l Bank & Trust Co.*, 335 U.S. 595, 600 (1949) (Frankfurter, J., dissenting).

[55] *Compare, e.g., United States* v. *Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897) (adopting a rule of *per se* invalidity for horizontal price-fixing agreements), *with Standard Oil Co. of New Jersey* v. *United States*, 221 U.S. 1 (1911) (adopting a rule-of-reason analysis for all horizontal agreements), *with United States* v. *Trenton Potteries Co.*, 273 U.S. 392 (1927) (readopting a rule of *per se* invalidity for horizontal price-fixing agreements), *with Appalachian Coals, Inc.* v. *United States*, 288 U.S. 344 (1933) (applying a rule of reason to a horizontal output-restriction agreement), *with United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940) (applying a rule of *per se* invalidity for horizontal price-fixing agreements), *with Broadcast Music, Inc.* v. *CBS*, 441 U.S. 1 (1979) (efficiency-enhancing horizontal price-fixing agreements may be subject to a rule-of-reason analysis), *with Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332 (1982) (applying a rule of *per se* invalidity for a horizontal maximum price-fixing agreement), *with NCAA* v. *Board of Regents of the Univ. of Oklahoma*, 468 U.S. 85 (1984) (applying a rule of reason to a horizontal agreement to limit output), *and with Palmer* v. *BRG of Georgia, Inc.*, 498 U.S. 46 (1990) (per curiam) (applying a rule of *per se* invalidity for a horizontal market allocation agreement). Or *compare Chicago Board of Trade* v. *United States*, 264 U.S. 231, 238 (1918) (identifying factors used in the rule-of-reason analysis), *with FTC* v. *Indiana Federation of Dentists*, 476 U.S. 447, 458-59 (1986) (articulating a so-called "quick look" analysis).

[56] *Compare, e.g., White Motor Co.* v. *United States*, 372 U.S. 253 (1963) (adopting rule-of-reason analysis for vertical nonprice restraints), *with United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967) (adopting a rule of *per se* invalidity for vertical nonprice restraints; overruling *White Motor*), *and with Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (abandoning a rule of *per se* invalidity for vertical nonprice restraints; overruling *Schwinn*). Or *compare Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911) (a manufacturer cannot force a distributor to agree on a

This Court had little experience with vertical restraints at the time that it decided *Dr. Miles*. William Baxter, former Assistant Attorney General for the Antitrust Division, made that point succinctly: "Unlike the early cases involving horizontal restraints, none of the early vertical restraint cases wrestled with economic principle and explored the implications of the then-rudimentary learning about price theory or industrial organization." [57] By outlawing the practice in *Dr. Miles*, however, this Court denied itself, the lower courts, the academy, and the bar the opportunity to acquire the experience with vertical pricing mechanisms that is necessary before a business practice should invariably be outlawed.[58]

In the last 30 years, however, this Court has held that two closely related practices—vertical nonprice restraints (such as territorial restrictions) and maximum resale price maintenance—should not be deemed *per se* unlawful under

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manufacturer's pricing recommendation), *with United States* v. *Colgate & Co.*, 250 U.S. 300 (1919) (a manufacturer may refuse to deal with a retailer that does not honor the manufacturer's pricing recommendations), *with United States* v. *General Elec. Co.*, 272 U.S. 476 (1926) (a manufacturer can set a resale price by consigning the goods to a distributor, instead of selling them), *and with United States* v. *Parke, Davis & Co.*, 362 U.S. 29 (1960), *and Simpson* v. *Union Oil Co.*, 377 U.S. 13 (1964) (a manufacturer cannot enforce its pricing recommendations). Or *compare Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968) (adopting a rule of *per se* invalidity for maximum resale price maintenance), *with State Oil Co.* v. *Khan*, 522 U.S. 3 (1997) (rejecting a rule of *per se* invalidity for maximum resale price maintenance; overruling *Albrecht*).

[57] Baxter, 75 CAL. L. REV. at 933; *see also* Hovenkamp, *The Antitrust Enterprise* 186.

[58] Hovenkamp, *The Antitrust Enterprise* 186; *see American Airlines, Inc.* v. *Wolens*, 513 U.S. 219, 234-35 (1995) ("[I]n our system of adjudication, principles seldom can be settled 'on the basis of one or two cases, but require a closer working out.'") (quoting Roscoe Pound, *Survey of the Conference Problems*, 14 U. CIN. L. REV. 324, 339 (1940) (Conference on the Status of the Rule of Judicial Precedent)).

the antitrust laws.[59] *Stare decisis* did not prevent this Court from overruling unsound precedents in those cases. The factors that this Court found persuasive there—particularly the economic utility of vertical restraints in promoting interbrand competition[60]—militate powerfully in favor of treating the vertical practice at issue here as another generally permissible business decision. The "lessons of accumulated experience" that this Court found convincing in *Sylvania* and *Khan* are equally instructive here.

* * * * *

It is inconceivable that this Court would conclude today, as a matter of first impression, that vertical resale price maintenance warrants *per se* condemnation. This case offers a perfect opportunity to revisit that issue. The Court adopted the *Dr. Miles* rule more than 95 years ago, long before it concluded that antitrust analysis should be guided by contemporary industrial organization theory. Contemporary antitrust legal and economic analysis has concluded that vertical restraints are usually procompetitive, not anticompetitive. And this case squarely presents the question whether the *Dr. Miles* rule should be overruled. The *Dr. Miles* rule has become an anachronism harmful to both competition and the development of sound antitrust law. This Court should overrule the *Dr. Miles* rule automatically and invariably condemning minimum resale price maintenance.

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[59] *Sylvania*, *supra*; *Khan*, *supra*.

[60] *Sylvania*, 433 U.S. at 49-52.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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JANUARY 2007

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(11)

FILED
JAN 22 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as
Kay's Kloset . . . Kay's Shoes,

Respondent.

On Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

BRIEF OF *AMICI CURIAE* ECONOMISTS IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Should minimum resale price maintenance continue to be deemed *per se* unlawful under Section 1 of the Sherman Act, or, in light of modern economic understanding and antitrust policy, should it instead be subject to the rule of reason, like other vertical price and non-price restraints?

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INTEREST OF *AMICI CURIAE*[1]

Amici, who are listed in the Appendix hereto, are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Eight of the *amici* have served as either Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency).

Amici submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the question presented; and to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

INTRODUCTION AND SUMMARY

The petition in this action addresses the antitrust treatment of minimum resale price maintenance ("RPM") agreements in which an upstream seller agrees with a buyer on the minimum price, or the exact price, at which the buyer will resell the goods. Minimum RPM has been treated as *per se* unlawful under Section 1 of the Sherman Act, 15 U.S.C.

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[1] *Amici* file this brief solely as individuals, and not on behalf of any institutions or organizations with which they are affiliated. No counsel for a party has authored this brief in whole or in part and no person or entity, other than *amici* or their counsel, has made a monetary contribution to the preparation or submission of this brief. Both parties have filed letters with the Court consenting to the filing of all amicus briefs.

§ 1, since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), except for the years 1937 to 1975 when it was partially exempted from the Sherman Act by statute. *See* Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 3-7 (Bureau of Econ., Fed. Trade Comm'n 1983). Other vertical restraints, including maximum RPM, in which a buyer and seller set a ceiling on the buyer's resale price, as well as almost all non-price vertical agreements, are now analyzed under the rule of reason, although they had previously been considered *per se* illegal. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum RPM); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical non-price agreements generally).

Amici urge the Court to reverse the decision of the United States Court of Appeals for the Fifth Circuit and hold that minimum RPM is subject to analysis under the rule of reason, rather than being illegal *per se*. This Court has frequently observed that the rule of reason is the presumptive standard for determining the legality of practices challenged as anticompetitive under the Sherman Act. *Per se* condemnation is reserved for conduct that almost never has a procompetitive effect and almost always has an anticompetitive effect.

In the lengthy period since this Court decided *Dr. Miles*, economic analysis of minimum RPM agreements has demonstrated that vertical restrictions between manufacturers and their dealers, including agreements on minimum resale prices, can enhance competition. Consistent with that teaching, this Court has overruled past decisions that held non-price vertical restraints and maximum RPM unlawful *per se*. The same reasoning should now lead this Court to treat minimum RPM in the same manner, thus abandoning an anachronistic distinction that finds no support in sound economic analysis.

RPM can have procompetitive effects under some circumstances, especially where manufacturers seek to deter free riding on welfare-enhancing investments in services by certain retailers. Even where free riding is not an issue, minimum RPM can sometimes be an efficiency-enhancing means to enforce commitments by resellers to invest in sales effort or to manage uncertainty in demand.

The economics literature does not support a conclusion that minimum RPM almost always produces anticompetitive effects. In many cases, interbrand competition precludes a manufacturer from setting resale prices above a competitive level. And regardless of the extent of interbrand competition, a manufacturer has, except in limited circumstances, little incentive to enrich its dealers by inducing them to impose noncompetitive mark-ups on its products. To the contrary, manufacturers generally have an incentive to require minimum mark-ups that will result in enhanced levels of service to increase total sales. That is a procompetitive effect that benefits manufacturers and consumers alike. While minimum RPM can be used in conjunction with a cartel at the manufacturer or dealer level, the economics literature does not indicate that it does so often, much less virtually all the time as would be necessary to justify a *per se* rule. Taken as a whole, the economics literature does not establish that minimum RPM satisfies this Court's strict criteria for *per se* treatment.

In *amici*'s view, moreover, it is important to bring the law governing non-price and price restraints into congruence. From an economics perspective, vertical price and non-price restraints are substantially identical in effect. Not only is there is no justification for treating the two types of restrictions in such a markedly disparate fashion where sound economic analysis fails to support the distinction, but doing so may force businesses to resort to non-price restraints in situations in which price restrictions may

provide the most effective and procompetitive way to ensure efficient conduct by dealers.

ARGUMENT

I. MINIMUM RPM DOES NOT SATISFY THIS COURT'S STANDARD FOR APPLICATION OF THE *PER SE* RULE

A. The *Per Se* Rule Should Apply Only to Conduct that Almost Never Is Procompetitive and Almost Always Is Anticompetitive

This Court has emphasized that antitrust claims are presumptively subject to rule of reason analysis and that *per se* condemnation is limited to a small class of alleged antitrust offenses whose character is well understood and that are virtually invariably harmful to competition. *See Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006). More specifically, the *per se* rule should be applied only to practices that almost invariably have no procompetitive effects and almost invariably have significant anticompetitive effects—or, as the Court has put it, that have a "pernicious effect on competition and lack . . . any redeeming virtue." *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958), *quoted in GTE Sylvania*, 433 U.S. at 58; *see also GTE Sylvania*, 433 U.S. at 50 (finding *per se* rules appropriate for "conduct that is manifestly anticompetitive"); *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979) (prescribing *per se* treatment when a "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output"). Under this formulation, there is no justification for applying the *per se* rule to minimum RPM.

B. Minimum RPM Can Be Procompetitive

RPM agreements include either a specific price at which a product must be resold or a floor below which the reseller

may not price in reselling the product. (Often, as here, the upstream seller is a manufacturer and the reseller is a retailer. Although that is not always the case, *amici* will use the terms "manufacturer" and "retailer" to denote the upstream seller and reseller, respectively.) An RPM agreement establishes a minimum mark-up for the retailer (the difference between the resale price and the wholesale price from the manufacturer).

Generally, a manufacturer wants retail margins to be low; having sold the product to the retailer, it wants the retailing function to be performed as efficiently as possible, with competing retailers, in turn, passing on to consumers the lowest price consistent with retailers' providing desired services and continuing in business. In real-world markets, however, the incentives facing retailers may be out of alignment with those of manufacturers, to the detriment of the manufacturers' ability to compete effectively with the products of competing manufacturers. In such cases, minimum RPM can help to align these incentives and enhance the competitiveness of a manufacturer's product, thereby benefiting consumers.

1. Eliminating "Free Riding"

There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.

In purchasing many products, consumers value services performed at the retail level—that is, the provision of these services increases the value of the product for consumers, and some consumers are willing to purchase the product with these services, whereas they would not be willing to

purchase the product if the services were not provided. In some situations, "the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher retail price." G. Franklin Mathewson & Ralph A. Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 67 (1998). The result is an increase in total demand and sales. In such cases, consumer welfare generally will also increase compared with the world in which the product is offered at a lower price but without the dealer's services. *See* Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* Issues in Competition Law and Policy (ABA Antitrust Section, Wayne Dale Collins ed., forthcoming 2007), *available at* http://www.virginia.edu/economics/papers/mills/RPM for ABA.pdf.

This phenomenon is likely to be most significant in cases for products that are differentiated and therefore are sold on the basis of features and quality as well as price. For example, a digital camera may require that a retailer explain its unique features and quality in order to realize its maximum sales against competing digital cameras with their own unique features, or against film cameras. Or, a fashion item such as the women's accessories at issue in this case may benefit from longer store hours, more convenient or prestigious store locations, better-trained and more enthusiastic employees, or favoritism in shelf placement. From an economics perspective, all of these services can enhance the quality (real or perceived) of the product because they demonstrably have value to consumers. In such cases, investment in retail services can make consumers, as well as manufacturers and retailers, better off.

Market imperfections, however, may lead retailers to offer less than the amount of support that would be best for manufacturers and consumers. The imperfection most

commonly discussed in the economic literature is the so-called "free-rider" problem. Free riders, in this context, are competing retailers that take advantage of the fact that a prospective customer is under no obligation to purchase the product from the retailer that invests in retail-level services. A customer may take advantage of one retailer's informed sales staff, hands-on demonstrations, and convenient shopping locations and hours. Having received the value of those services, the customer may then purchase the product from another retailer that does not provide the same level of service and, therefore, can afford to sell the product for less. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960); G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337 (1983). For example, a customer may inspect, try out, and learn about a particular type of digital camera at a high-end retailer but then purchase the product from a discount retailer, through mail order, or over the internet.

Free riding creates externalities that lead each retailer—and thus retailers collectively—to spend less on service than is optimal. Each retailer's incentive is to invest in service only to the extent that the additional service costs are recouped through *its* increased sales. Some of the increased sales go to the free-riding retailers, and the full-service retailer properly ignores them when computing its gain from spending more on service. It thus spends less on service than would maximize total sales of the manufacturer's product.

Free riding can also take place where the thing of value provided by the higher-priced retailer is not services, but quality "signaling." *See* Overstreet, *supra*, at 56. Some retailers build a reputation for carrying high-quality or cutting-edge merchandise. Building such a reputation requires an investment, not only in product lines, but in the store's reputation through advertising, location, and other

expenditures. *See* Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974). These investments in quality signaling also have the potential to be free-ridden upon: consumers can observe that a brand is sold in a store that they believe would sell only high-quality merchandise and, having concluded that the product is therefore of high quality, purchase it at a discount retailer that also carries it. Minimum RPM in this situation, just as in the services context, can protect the investment of the quality-signaling retailer and help ensure that this retailer can continue to fulfill this function, which for some products is of value both to consumers and to manufacturers and enhances interbrand competition. *See* Overstreet, *supra*, at 56-62.

Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do. By mandating a minimum resale price, the manufacturer can calibrate the level of services offered by retailers to the level at which the manufacturer's profits are maximized (which, once the manufacturer has set its price, is when the greatest amount of output is sold). In some instances, full-service retailers may actually charge less under minimum RPM, because they will be assured of more volume that otherwise would have gone to free-riding discounters. In the long run, minimum RPM thus may "reduce the maximum, and possibly the average, price charged" for the product. Mathewson & Winter, *supra*, 21 Econ. Inquiry at 347. Where free riding exists, minimum RPM arrangements generally increase overall consumer welfare. *See id.*; *see also* Elzinga & Mills, *supra*, manuscript at 7-9 (discussing the conditions under which minimum RPM may increase or decrease total welfare). One reason for the likely net procompetitive effect is that, as explained below, manufacturers have strong incentives to avoid prescribing resale prices that increase retailer margins without inducing them to provide desired retail services.

Minimum RPM is not the only method by which manufacturers can address free-riding concerns, but under some circumstances it may be the only practical one or the most competitive one. There are three principal ways other than RPM to address free riding. First, manufacturers can contract with retailers for specific services. However, the nature of marketing and selling is such that it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them. It is also possible that the retailer, rather than the manufacturer, knows which retail-level services will be most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer. Alternatively, manufacturers could charge consumers directly for point-of-sale services. However, that normally is not practical because the services provided by retailers frequently are informational or because there are economies of scale or scope that retailers which sell a range of products can take advantage of, thereby reducing their cost of providing such services. Finally, a manufacturer might use non-price vertical restraints (such as exclusive territories) to preclude *all* competition from free riders. As discussed below, this alternative is more restrictive of competition and perhaps less efficient than minimum RPM.

The potential for RPM to ameliorate a free riding problem and thereby enhance interbrand competition does not mean that it is procompetitive in every case. While alternative methods of curtailing free riding might not, as explained above, always be available or most efficient, where they are RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition. Moreover, the benefits of RPM may be meager in highly concentrated markets where there is not much interbrand competition to be enhanced. *See* F.M.

Scherer, *Industrial Market Structure and Economic Performance* 542-49 (3d ed. 1990) (showing that RPM may reduce both consumer and social welfare under a plausible hypothesis regarding its impact on demand for the product); Robert L. Steiner, *The Nature of Vertical Restraints*, 30 Antitrust Bull. 143 (1985) (arguing that certain types of vertical restraints, including exclusive dealing coupled with RPM, are especially detrimental to intrabrand competition).

2. Ensuring Dealer Contribution to Product Quality

Even absent free riding, retailers may not be inclined to make the level of investments in service that would maximize the overall competitiveness of a manufacturer's products. According to Klein and Murphy, minimum RPM can help ensure a desired level of investment in retail services. A manufacturer can threaten to terminate a dealer that provides inadequate service, but given the difficulties of monitoring service levels a retailer may be willing to bear the risk of termination rather than incur the cost of providing additional services. It may be less inclined to do so where the risk it faces is losing an RPM-enhanced margin. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265, 265-70 (1988); *see also* Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597 (1993) (applying the Klein-Murphy theory to RPM cases litigated before the advent of modern economic thought about vertical restraints).

With minimum RPM, retailers' choice of value-added services are determined and disciplined by market competition with other retailers. By eliminating intrabrand price competition among dealers, minimum RPM effectively shifts intrabrand competition to the non-price arena—that is, retailers compete to find the service package that best drives sales of the product. Elzinga & Mills, *supra*, manuscript at

4. This competition benefits consumers, who receive the package of retail-level services most useful to them; benefits retailers that develop the package, and thereby compete successfully against other retailers selling either the same or different products; and benefits the manufacturer, whose sales thereby increase.

3. Managing Demand Uncertainty

There is also support for the proposition that RPM can help to stabilize demand for a product where retailers must order their inventories of the product before demand for it is known. *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997). If demand proves unexpectedly low after retailers have acquired a substantial inventory, prices can plummet as retailers liquidate their holdings. By preventing this precipitous decline, minimum RPM can benefit consumers by encouraging retailers to maintain appropriate inventory levels. Knowing that RPM provides them with some protection in case demand is low, dealers may be willing to place larger orders in advance of knowing the demand, thereby ensuring adequate stocks if demand turns out to be high. Similarly, dealers may be more willing to invest in inventory in more innovative and risky products or styles, which can enhance product variety and benefit competition and consumers.

C. The Economics Literature Does Not Support the Conclusion that Minimum RPM Often, Much Less Invariably, Has an Anticompetitive Effect

1. Minimum RPM's Enhancement of Interbrand Competition Offsets Its Effect on Intrabrand Competition

Minimum RPM inherently restrains intrabrand price competition (competition among resellers of the brand that is

the subject of the agreement). As this Court has recognized, however, the principal form of competition that the antitrust laws encourage is interbrand competition (competition among the products of different manufacturers). *See, e.g.*, *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724-26 (1988); *GTE Sylvania*, 433 U.S. at 54-55. As noted above, the manufacturer that uses minimum RPM can enhance interbrand competition by causing resellers to provide additional services that will increase the product's competitiveness against other products and increase sales of the product. Thus, even where minimum RPM raises the price charged by a given retailer, that does not mean that there is necessarily an anticompetitive effect. *See Sharp*, 485 U.S. at 728.

In a world of imperfect information, it is, of course, possible that a manufacturer will erroneously prescribe minimum resale prices that are higher than optimal and that will lead to lower, not higher, sales. But the manufacturer has incentives to avoid doing so. It gains no profits from having its dealers charge excessive prices or furnish unwanted service. To the contrary, where the prescribed resale price exceeds the level that optimizes the sales of the brand, the manufacturer is the loser, just as it is where the price is below the optimal level. In the ordinary case, therefore, manufacturers will strive to avoid setting resale prices above what the market calls for. In all events, it is not the function—or capacity—of antitrust law to prevent such errors. That is what markets are for. *See* Elzinga & Mills, *supra*, manuscript at 9 (citing Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981)); *see also* Frank H. Easterbrook, *Contract and Copyright*, 42 Hous. L. Rev. 953, 957 (2005) ("Markets are *much* better than judges at sifting efficient from anticompetitive practices." (emphasis in original)).

2. *The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Manufacturer Cartels*

One objection to minimum RPM that had some traction historically is that it might be used to facilitate a cartel at the manufacturer level. There is no reason to believe, however, that this occurs frequently, or that a *per se* rule is needed to address any cases in which it does occur.

Most cartels do not involve manipulation or control of downstream resale prices, but minimum RPM has been proposed as one means by which a cartel can dissuade cheating by its members, which have incentives to reduce prices slightly and thereby gain market share. Cartel members seeking to prevent "cheating" on their agreement ideally would observe each other's prices directly. Market circumstances or prudence, however, may preclude that from happening. As an alternative, manufacturers might agree to impose RPM agreements on their dealers, so that any reduction in price by a manufacturer could not be passed on to the consumer by the retailer, but would enrich only the retailer. With no benefit to consumers, demand for the product would not increase, and the would-be "cheat" would not benefit from its reduced prices.

There are reasons to believe that this type of use of minimum RPM would not be very common.

First, this situation could arise only where manufacturers had agreed to a criminal cartel and where market conditions made such a cartel practical. Thus, it would not apply where a manufacturer is law-abiding or where the number of competing manufacturers, the ease of entry, or other market circumstances rendered a successful cartel implausible. *See* Overstreet, *supra*, at 19-23. *See generally* George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964) (discussing prerequisites for effective horizontal coordination); U.S.

Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* §§ 2.11, 2.12 (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 2, 1992) (same).

Second, it would not apply where compliance with a conspiracy can be monitored without RPM. It is noteworthy that minimum RPM has not been generally reported as an enforcement mechanism in the major price-fixing cartels that the Department of Justice has prosecuted in the past decade.

Third, there is no empirical evidence that minimum RPM is used with any frequency in this manner. To the contrary, the empirical evidence that does exist suggests that such use of minimum RPM is not common. In 1991, Pauline Ippolito of the Federal Trade Commission reported a study of the frequency with which both manufacturer cartels and retailer cartels (discussed below) were alleged in the 153 reported minimum RPM cases from 1976 to 1982. *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991). Ippolito found that only 5.9 percent of the cases involved allegations of horizontal manufacturer price fixing in addition to RPM. She concluded, "[o]n this basis, there is little evidence . . . to support the hypothesis that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM." *Id.* at 281.

3. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Reseller Cartels

It also has been suggested that minimum RPM could be used to facilitate reseller cartels. *See* Basil S. Yamey, *Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade*, 62 Econ. J. 522 (1952). Retailers that sought to form a cartel could induce manufacturers to implement minimum RPM agreements and thereby become the cartel's enforcement mechanism.

For many of the reasons mentioned above with respect to manufacturer conspiracies, the use of minimum RPM to enforce dealer cartels is not likely to be very common. Such a situation would require a retail market with high barriers to entry, because manufacturers would otherwise sell through non-colluding, lower-margin dealers. Cartelization is also an unlikely motive in markets where only one or few competitors implement RPM programs because otherwise consumers could switch to brands not encumbered by collusive retail margins. Moreover, because dealers often can observe each other's prices directly, participation by suppliers in such a cartel through minimum RPM agreements is unlikely to be necessary.

In addition, the manufacturer—a key element in these agreements—receives no benefit from a dealer cartel, but on the contrary, suffers diminished sales. Therefore, manufacturers generally lack incentives to cooperate in furthering a dealer cartel.

As with manufacturer cartels, the empirical evidence lends no support to the suggestion that minimum RPM often facilitates retailer cartels. In Ippolito's 1991 study, only 7.2 percent of the 153 minimum RPM cases reported between 1976 and 1982 contained allegations of collusion among dealers. This contributed to Ippolito's conclusion that "this evidence suggests that, on the margin, a relaxation of the *per se* rule against RPM would primarily affect noncollusive uses of RPM." Ippolito, *supra*, 34 J.L. & Econ. at 282. Overstreet, in a 1983 survey of litigated FTC minimum RPM cases, found that of the 47 cases between 1965 and 1982 for which information was available on retail market structure, 43 involved at least 100 competing retailers, a situation in which "[w]idespread dealer collusion . . . seems unlikely to be effective or persistent" absent certain market conditions. Overstreet, *supra*, at 80. He observed that "[i]t seems reasonable to conclude that for the majority of these (47)

cases the use of RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel." *Id.*

4. The Disagreements in the Economics Literature Provide No Basis for a Per Se *Rule*

There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects. Upon careful scrutiny, however, it is apparent that the range of the disagreements underscores that a rule of *per se* illegality should not be applied to minimum RPM.

In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue. The critical issue is the boundaries of that dispute. Some believe that minimum RPM is almost always benign and thus should basically be ignored by antitrust law except when it is part of a cartel case. *See, e.g.*, Elzinga & Mills, *supra*, manuscript at 14-15. Others believe that RPM has been demonstrated to be anticompetitive in some cases and thus merits serious antitrust consideration. *See, e.g.*, F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Competition Pol'y Int'l 65 (2005); William S. Comanor et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* (Am. Antitrust Inst. Working Paper No. 05-04, Apr. 18, 2005), *available at* http://www.antitrustinstitute.org/recent2/408.pdf. The position absent from the literature is that minimum RPM is most often, much less almost invariably, anticompetitive. Thus, the economics literature provides no support for the application of a *per se* rule.

II. RULE OF REASON TREATMENT OF MINIMUM RPM IS NEEDED TO MAINTAIN DESIRABLE CONSISTENCY BETWEEN PRICE AND NON-PRICE RESTRAINTS

Antitrust law has moved steadily in the direction of evaluating vertical restraints under the rule of reason, and appropriately so. Maximum RPM and all forms of vertical non-price restraints (except, nominally, some tying arrangements) are now subject to assessment under the rule of reason.

Applying the rule of reason to minimum RPM, like almost all other vertical restraints, is appropriate because there is little difference in economic substance between price and non-price restraints. Compare minimum RPM, for example, to territorial exclusivity. Like minimum RPM, exclusive territories relieve dealers of being in price competition with each other as to the same brand of product. Yet, under the present state of the law the former is *per se* illegal whereas the latter is judged under the rule of reason.

This divergent treatment is particularly ironic because to the extent that there is a difference in economic effect between the practices it is that minimum RPM permits *more* competition. As noted, both practices eliminate intrabrand price competition. Minimum RPM, however, unlike exclusive territories, permits intrabrand non-price competition. Moreover, it leaves multiple sellers of the brand in the same geographic market to engage in interbrand competition.

Minimum RPM also may be the more efficient means of solving the free-rider problem. For example, a manufacturer may find it most efficient to have one dealer on each side of a city, because some (but not all) customers shop only on their side of a city. The free-rider problem created by those customers who would travel to the other side for a lower

price could be solved by giving one dealer an exclusive territory covering the entire city, but that solution would be inefficient in that it would forsake those consumers who would not travel across town to the remaining dealer. As compared to the use of minimum RPM to solve the free-rider problem, both the manufacturer and consumers would be worse off.

Amici submit that the Court, therefore, ought to reverse the Fifth Circuit's decision in order to reconcile the standards applicable to price and non-price restraints. There is, to be sure, economic value in precedent. By its nature, however, antitrust is intended to evolve along with economics learning and, as *GTE Sylvania* and *Khan* demonstrate, the Court has not hesitated to abandon decisions whose economic underpinning has been eroded and whose continued existence impedes, as opposed to advances, economic efficiency and consumer welfare. *Amici* respectfully submit that the rule in *Dr. Miles* cannot be reconciled with this Court's analysis in *GTE Sylvania*. By far, a more appropriate rule is to evaluate vertical minimum resale price agreements under the traditional rule of reason standard.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision of the United States Court of Appeals for the Fifth Circuit and overrule the *per se* rule against minimum RPM.

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21

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as
Kay's Kloset . . . Kay's Shoes,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF *AMICI CURIAE* ECONOMISTS IN SUPPORT OF PETITIONER

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November 3, 2006

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Pursuant to this Court's Rule 37.2(b), a group of distinguished economists (listed in the Appendix to the proposed brief) respectfully requests leave of this Court to file the attached brief as *amici curiae* supporting Petitioner. Petitioner has consented to the filing of this brief, but Respondent has withheld such consent, thus necessitating the filing of this motion.

The proposed *amici* are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Nine of them have served as either the Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice.

They submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the case to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

Based on the foregoing, proposed *amici* hereby move for leave to file this brief *amici curiae* in support of Petitioner.

Respectfully submitted,

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November 3, 2006

QUESTION PRESENTED

Should minimum resale price maintenance continue to be deemed *per se* unlawful under Section 1 of the Sherman Act, or, in light of modern economic understanding and antitrust policy, should it instead be subject to the rule of reason, like other vertical price and non-price restraints?

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INTEREST OF *AMICI CURIAE*[1]

Amici, who are listed in the Appendix hereto, are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Nine of the *amici* have served as either the Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency).

Amici submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the question presented; and to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

INTRODUCTION AND SUMMARY

The petition in this action addresses the antitrust treatment of minimum resale price maintenance ("RPM") agreements in which an upstream seller agrees with a buyer on the minimum price, or the exact price, at which the buyer will resell the goods. Minimum RPM has been treated as *per se* unlawful under Section 1 of the Sherman Act, 15 U.S.C. § 1, since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), except for the years 1937 to 1975

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[1] *Amici* file this brief solely as individuals, and not on behalf of any institutions or organizations with which they are affiliated. No counsel for a party has authored this brief in whole or in part and no person or entity, other than *amici* or their counsel, has made a monetary contribution to the preparation or submission of this brief.

when it was partially exempted from the Sherman Act by statute. *See* Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 3-7 (Bureau of Econ., Fed. Trade Comm'n 1983). Other vertical restraints, including maximum RPM, in which a buyer and seller set a ceiling on the buyer's resale price, as well as almost all non-price vertical agreements, are now analyzed under the rule of reason, although they had previously been considered *per se* illegal. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum RPM); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical non-price agreements generally).

Amici urge the Court to grant the Petition for Writ of Certiorari in this case and, ultimately, determine that minimum RPM is subject to analysis under the rule of reason, rather than being illegal *per se*. This Court has frequently observed that the rule of reason is the presumptive standard for determining the legality of practices challenged as anticompetitive under the Sherman Act. *Per se* condemnation is reserved for conduct that almost never has a procompetitive effect and almost always has an anticompetitive effect.

In the lengthy period since this Court decided *Dr. Miles*, economic analysis of minimum RPM agreements has demonstrated that vertical restrictions between manufacturers and their dealers, including agreements on minimum resale prices, can enhance competition. Consistent with that teaching, this Court has overruled past decisions that held non-price vertical restraints and maximum RPM unlawful *per se*. The same reasoning should now lead this Court to treat minimum RPM in the same manner, thus abandoning an anachronistic distinction that finds no support in sound economic analysis.

RPM can have procompetitive effects under some common circumstances, especially where manufacturers

seek to deter free riding on welfare-enhancing investments in services by certain retailers. Even where free riding is not an issue, minimum RPM can sometimes be an efficiency-enhancing means to enforce commitments by resellers to invest in sales effort or to manage uncertainty in demand.

The economics literature provides no basis for concluding that minimum RPM almost always produces anticompetitive effects. In many if not most cases, interbrand competition precludes a manufacturer from setting resale prices above a competitive level. And regardless of the extent of interbrand competition, a manufacturer has little incentive to enrich its dealers by inducing them to impose noncompetitive mark-ups on its products. To the contrary, manufacturers have an incentive to require minimum mark-ups that will result in enhanced levels of service to increase total sales. That is a procompetitive effect which benefits manufacturers and consumers alike. While it is possible that minimum RPM could be used in conjunction with a cartel at the manufacturer or dealer level, the economics literature does not indicate that it does so often, much less virtually all the time as would be necessary to justify a *per se* rule. Taken as a whole, the economics literature does not establish that minimum RPM satisfies this Court's strict criteria for *per se* treatment.

In *amici*'s view, moreover, it is important to bring the law governing non-price and price restraints into congruence. From an economics perspective, vertical price and non-price restraints are substantially identical in effect. Not only is there is no justification for treating the two types of restrictions in such a markedly disparate fashion where sound economic analysis fails to support the distinction, but doing so may force businesses to resort to non-price restraints in situations in which price restrictions may

provide the most effective and procompetitive way to ensure efficient conduct by dealers.

ARGUMENT

I. MINIMUM RPM DOES NOT SATISFY THIS COURT'S STANDARD FOR APPLICATION OF THE *PER SE* RULE

A. The *Per Se* Rule Should Apply Only to Conduct that Almost Never Is Procompetitive and Almost Always Is Anticompetitive

This Court has emphasized that antitrust claims are presumptively subject to rule of reason analysis and that *per se* condemnation is limited to a small class of alleged antitrust offenses whose character is well understood and that are virtually invariably harmful to competition. *See Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006). More specifically, the *per se* rule should be applied only to practices that almost invariably have no procompetitive effects and almost invariably have significant anticompetitive effects—or, as the Court has put it, that have a "pernicious effect on competition and lack . . . any redeeming virtue." *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958), *quoted in GTE Sylvania*, 433 U.S. at 58; *see also GTE Sylvania*, 433 U.S. at 50 (finding *per se* rules appropriate for "conduct that is manifestly anticompetitive"); *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979) (prescribing *per se* treatment when a "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output"). Under this formulation, there is no justification for applying the *per se* rule to minimum RPM.

B. Minimum RPM Can Be Procompetitive

RPM agreements include either a specific price at which a product must be resold or a floor below which the reseller

may not price in reselling the product. (Often, as here, the upstream seller is a manufacturer and the reseller is a retailer. Although that is not always the case, *amici* will use the terms "manufacturer" and "retailer" to denote the upstream seller and reseller, respectively.) An RPM agreement establishes a minimum mark-up for the retailer (the difference between the resale price and the wholesale price from the manufacturer).

Generally, a manufacturer wants retail margins to be low; having sold the product to the retailer, it wants the retailing function to be performed as efficiently as possible, with competing retailers, in turn, passing on to consumers the lowest price consistent with retailers' providing desired services and continuing in business. In real-world markets, however, the incentives facing retailers may be out of alignment with those of manufacturers, to the detriment of the manufacturers' ability to compete effectively with the products of competing manufacturers. In such cases, minimum RPM can help to align these incentives and enhance the competitiveness of a manufacturer's product, thereby benefiting consumers.

1. Eliminating "Free Riding"

There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.

In purchasing many products, consumers value services performed at the retail level—that is, the provision of these services increases the value of the product for consumers, and some consumers are willing to purchase the product with these services, whereas they would not be willing to

purchase the product if the services were not provided. In some situations, "the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher retail price." G. Franklin Mathewson & Ralph A. Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 67 (1998). The result is an increase in total demand and sales. In such cases, consumer welfare generally will also increase compared with the world in which the product is offered at a lower price but without the dealer's services. *See* Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* Issues in Competition Law and Policy (ABA Antitrust Section, Wayne Dale Collins ed., forthcoming 2007), *available at* http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf.

This phenomenon is likely to be most significant in cases for products that are differentiated and therefore are sold on the basis of features and quality as well as price. For example, a digital camera may require that a retailer explain its unique features and quality in order to realize its maximum sales against competing digital cameras with their own unique features, or against film cameras. Or, a fashion item such as the women's accessories at issue in this case may benefit from longer store hours, more convenient or prestigious store locations, better-trained and more enthusiastic employees, or favoritism in shelf placement. From an economics perspective, all of these services can enhance the quality (real or perceived) of the product because they demonstrably have value to consumers. In such cases, investment in retail services can make consumers, as well as manufacturers and retailers, better off.

Market imperfections, however, may lead retailers to offer less than the amount of support that would be best for manufacturers and consumers. The imperfection most

commonly discussed in the economic literature is the so-called "free-rider" problem. Free riders, in this context, are competing retailers that take advantage of the fact that a prospective customer is under no obligation to purchase the product from the retailer that invests in retail-level services. A customer may take advantage of one retailer's informed sales staff, hands-on demonstrations, and convenient shopping locations and hours. Having received the value of those services, the potential customer may then purchase the product from another retailer that does not provide the same level of service and, therefore, can afford to sell the product for less. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960); G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337 (1983). For example, a customer may inspect, try out, and learn about a particular type of digital camera at a high-end retailer but then purchase the product from a discount retailer, through mail order, or over the internet.

Free riding creates externalities that lead each retailer—and thus retailers collectively—to spend less on service than is optimal. Each retailer's incentive is to invest in service only to the extent that the additional service costs are recouped through *its* increased sales. Some of the increased sales go to the free-riding retailers, and the full-service retailer properly ignores them when computing its gain from spending more on service. It thus spends less on service than would maximize total sales of the manufacturer's product.

Free riding can also take place where the thing of value provided by the higher-priced retailer is not services, but quality "signaling." *See* Overstreet, *supra*, at 56. Some retailers build a reputation for carrying high-quality or cutting-edge merchandise. Building such a reputation requires an investment, not only in product lines, but in the store's reputation through advertising, location, and other

expenditures. *See* Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974). These investments in quality signaling also have the potential to be free-ridden upon: consumers can observe that a brand is sold in a store that they believe would sell only high-quality merchandise and, having concluded that the product is therefore of high quality, purchase it at a discount retailer that also carries it. Minimum RPM in this situation, just as in the services context, can protect the investment of the quality-signaling retailer and help ensure that this retailer can continue to fulfill this function, which for some products is of value both to consumers and to manufacturers and enhances interbrand competition. *See* Overstreet, *supra*, at 56-62.

Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do. By mandating a minimum resale price, the manufacturer can calibrate the level of services offered by retailers to the level at which the manufacturer's profits are maximized (which, once the manufacturer has set its price, is when the greatest amount of output is sold). In some instances, full-service retailers may actually charge less under minimum RPM, because they will be assured of more volume that otherwise would have gone to free-riding discounters. In the long run, minimum RPM thus may "reduce the maximum, and possibly the average, price charged" for the product. Mathewson & Winter, *supra*, 21 Econ. Inquiry at 347. Where free riding exists, minimum RPM arrangements generally increase overall consumer welfare. *See id.*; *see also* Elzinga & Mills, *supra*, manuscript at 7-9 (discussing the conditions under which minimum RPM may increase or decrease total welfare). One reason for the likely net procompetitive effect is that, as explained below, manufacturers have strong incentives to avoid prescribing resale prices that increase retailer margins without inducing them to provide desired retail services.

Minimum RPM is not the only method by which manufacturers can address free-riding concerns, but under some circumstances it may be the only practical one or the most competitive one. There are three principal ways other than RPM to address free riding. First, manufacturers can contract with retailers for specific services. However, the nature of marketing and selling is such that it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them. It is also possible that the retailer, rather than the manufacturer, knows which retail-level services will be most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer. Alternatively, manufacturers could charge consumers directly for point-of-sale services. However, that normally is not practical because the services provided by retailers frequently are informational or because there are economies of scale or scope that retailers which sell a range of products can take advantage of, thereby reducing their cost of providing such services. Finally, a manufacturer might use non-price vertical restraints (such as exclusive territories) to preclude *all* competition from free riders. As discussed below, this alternative is more restrictive of competition and perhaps less efficient than minimum RPM.

2. Ensuring Dealer Contribution to Product Quality

Even absent free riding, retailers may not be inclined to make the level of investments in service that would maximize the overall competitiveness of a manufacturer's products. According to Klein and Murphy, minimum RPM can help ensure a desired level of investment in retail services. A manufacturer can threaten to terminate a dealer that provides inadequate service, but given the difficulties of

monitoring service levels a retailer may be willing to bear the risk of termination rather than incur the cost of providing additional services. It may be less inclined to do so where the risk it faces is losing an RPM-enhanced margin. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265, 265-70 (1988); *see also* Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597 (1993) (applying the Klein-Murphy theory to RPM cases litigated before the advent of modern economic thought about vertical restraints).

With minimum RPM, retailers' choice of value-added services are determined and disciplined by market competition with other retailers. By eliminating intrabrand price competition among dealers, minimum RPM effectively shifts intrabrand competition to the non-price arena—that is, retailers compete to find the service package that best drives sales of the product. Elzinga & Mills, *supra*, manuscript at 4. This competition benefits consumers, who receive the package of retail-level services most useful to them; benefits retailers that develop the package, and thereby compete successfully against other retailers selling either the same or different products; and benefits the manufacturer, whose sales thereby increase.

3. Managing Demand Uncertainty

There is also support for the proposition that RPM can help to stabilize demand for a product where retailers must order their inventories of the product before demand for it is known. *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997). If demand proves unexpectedly low after retailers have acquired a substantial inventory, prices can plummet as retailers liquidate their holdings. By preventing this precipitous decline, minimum RPM can benefit consumers

by encouraging retailers to maintain appropriate inventory levels. Knowing that RPM provides them with some protection in case demand is low, dealers may be willing to place larger orders in advance of knowing the demand, thereby ensuring adequate stocks if demand turns out to be high. Similarly, dealers may be more willing to invest in inventory in more innovative and risky products or styles, which can enhance product variety and benefit competition and consumers.

C. The Economics Literature Does Not Support the Conclusion that Minimum RPM Often, Much Less Invariably, Has an Anticompetitive Effect

1. Minimum RPM's Enhancement of Interbrand Competition Offsets Its Effect on Intrabrand Competition

Minimum RPM inherently restrains intrabrand price competition (competition among resellers of the brand that is the subject of the agreement). As this Court has recognized, however, the principal form of competition that the antitrust laws encourage is interbrand competition (competition among the products of different manufacturers). *See, e.g., Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724-26 (1988); *GTE Sylvania*, 433 U.S. at 54-55. As noted above, the manufacturer that uses minimum RPM can enhance interbrand competition by causing resellers to provide additional services that will increase the product's competitiveness against other products and increase sales of the product. Thus, even where minimum RPM raises the price charged by a given retailer, that does not mean that there is necessarily an anticompetitive effect. *See Sharp*, 485 U.S. at 728.

In a world of imperfect information, it is, of course, possible that a manufacturer will erroneously prescribe minimum resale prices that are higher than optimal and that

will lead to lower, not higher, sales. But the manufacturer has incentives to avoid doing so. It gains no profits from having its dealers charge excessive prices or furnish unwanted service. To the contrary, where the prescribed resale price exceeds the level that optimizes the sales of the brand, the manufacturer is the loser, just as it is where the price is below the optimal level. In the ordinary case, therefore, manufacturers will strive to avoid setting resale prices above what the market calls for. In all events, it is not the function—or capacity—of antitrust law to prevent such errors. That is what markets are for. *See* Elzinga & Mills, *supra*, manuscript at 9 (citing Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981)); *see also* Frank H. Easterbrook, *Contract and Copyright*, 42 Hous. L. Rev. 953, 957 (2005) ("Markets are *much* better than judges at sifting efficient from anticompetitive practices." (emphasis in original)).

2. *The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Manufacturer Cartels*

One objection to minimum RPM that had some traction historically is that it might be used to facilitate a cartel at the manufacturer level. There is no reason to believe, however, that this occurs frequently, or that a *per se* rule is needed to address any cases in which it does occur.

Most cartels do not involve manipulation or control of downstream resale prices, but minimum RPM has been proposed as one means by which a cartel can dissuade cheating by its members, which have incentives to reduce prices slightly and thereby gain market share. Cartel members seeking to prevent "cheating" on their agreement ideally would observe each other's prices directly. Market circumstances or prudence, however, may preclude that from happening. As an alternative, manufacturers might agree to

impose RPM agreements on their dealers, so that any reduction in price by a manufacturer could not be passed on to the consumer by the retailer, but would enrich only the retailer. With no benefit to consumers, demand for the product would not increase, and the would-be "cheat" would not benefit from its reduced prices.

There are reasons to believe that this type of use of minimum RPM would not be very common.

First, this situation could arise only where manufacturers had agreed to a criminal cartel and where market conditions made such a cartel practical. Thus, it would not apply where a manufacturer is law-abiding or where the number of competing manufacturers, the ease of entry, or other market circumstances rendered a successful cartel implausible. *See* Overstreet, *supra*, at 19-23. *See generally* George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964) (discussing prerequisites for effective horizontal coordination); U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* §§ 2.11, 2.12 (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 2, 1992) (same).

Second, it would not apply where compliance with a conspiracy can be monitored without RPM. It is noteworthy that minimum RPM has not been generally reported as an enforcement mechanism in the major price-fixing cartels that the Department of Justice has prosecuted in the past decade.

Third, there is no empirical evidence that minimum RPM is used with any frequency in this manner. To the contrary, the empirical evidence that does exist suggests that such use of minimum RPM is not common. In 1991, Pauline Ippolito of the Federal Trade Commission reported a study of the frequency with which both manufacturer cartels and retailer cartels (discussed below) were alleged in the 153 reported minimum RPM cases from 1976 to 1982. *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence*

from Litigation, 34 J.L. & Econ. 263 (1991). Ippolito found that only 5.9 percent of the cases involved allegations of horizontal manufacturer price fixing in addition to RPM. She concluded, "[o]n this basis, there is little evidence . . . to support the hypothesis that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM." *Id.* at 281.

3. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Reseller Cartels

It also has been suggested that minimum RPM could be used to facilitate reseller cartels. *See* Basil S. Yamey, *Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade*, 62 Econ. J. 522 (1952). Retailers that sought to form a cartel could induce manufacturers to implement minimum RPM agreements and thereby become the cartel's enforcement mechanism.

For many of the reasons mentioned above with respect to manufacturer conspiracies, the use of minimum RPM to enforce dealer cartels is not likely to be very common. Such a situation would require a retail market with high barriers to entry, because manufacturers would otherwise sell through non-colluding, lower-margin dealers. Cartelization is also an unlikely motive in markets where only one or few competitors implement RPM programs because otherwise consumers could switch to brands not encumbered by collusive retail margins. Moreover, because dealers often can observe each other's prices directly, participation by suppliers in such a cartel through minimum RPM agreements is unlikely to be necessary.

In addition, the manufacturer—a key element in these agreements—receives no benefit from a dealer cartel, but on the contrary, suffers diminished sales. Therefore,

manufacturers generally lack incentives to cooperate in furthering a dealer cartel.

As with manufacturer cartels, the empirical evidence lends no support to the suggestion that minimum RPM often facilitates retailer cartels. In Ippolito's 1991 study, only 7.2 percent of the 153 minimum RPM cases reported between 1976 and 1982 contained allegations of collusion among dealers. This contributed to Ippolito's conclusion that "this evidence suggests that, on the margin, a relaxation of the *per se* rule against RPM would primarily affect noncollusive uses of RPM." Ippolito, *supra*, 34 J.L. & Econ. at 282. Overstreet, in a 1983 survey of litigated FTC minimum RPM cases, found that of the 47 cases between 1965 and 1982 for which information was available on retail market structure, 43 involved at least 100 competing retailers, a situation in which "[w]idespread dealer collusion . . . seems unlikely to be effective or persistent" absent certain market conditions. Overstreet, *supra*, at 80. He observed that "[i]t seems reasonable to conclude that for the majority of these (47) cases the use of RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel." *Id.*

4. The Disagreements in the Economics Literature Provide No Basis for a Per Se *Rule*

There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects. Upon careful scrutiny, however, it is apparent that the range of the disagreements underscores that a rule of *per se* illegality should not be applied to minimum RPM.

In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature

relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue. The critical issue is the boundaries of that dispute. Some believe that minimum RPM is almost always benign and thus should basically be ignored by antitrust law. *See, e.g.*, James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference* (Vanderbilt Univ. Law Sch., Law & Econ. Working Paper 05-12, Feb. 18, 2005), *available at* http://ssrn.com/abstract=699601. Others believe that RPM has been demonstrated to be anticompetitive in some cases and thus merits serious antitrust consideration. *See, e.g.*, F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Competition Pol'y Int'l 65 (2005); William S. Comanor et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* (Am. Antitrust Inst. Working Paper No. 05-04, Apr. 18, 2005), *available at* http://www.antitrustinstitute.org/recent2/408.pdf. The position absent from the literature is that minimum RPM is most often, much less almost invariably, anticompetitive. Thus, the economics literature provides no support for the application of a *per se* rule.

II. RULE OF REASON TREATMENT OF MINIMUM RPM IS NEEDED TO MAINTAIN DESIRABLE CONSISTENCY BETWEEN PRICE AND NON-PRICE RESTRAINTS

Antitrust law has moved steadily in the direction of evaluating vertical restraints under the rule of reason, and appropriately so. Maximum RPM and all forms of vertical non-price restraints (except, nominally, some tying arrangements) are now subject to assessment under the rule of reason.

Applying the rule of reason to minimum RPM, like almost all other vertical restraints, is appropriate because there is little difference in economic substance between price

and non-price restraints. Compare minimum RPM, for example, to territorial exclusivity. Like minimum RPM, exclusive territories relieve dealers of being in price competition with each other as to the same brand of product. Yet, under the present state of the law the former is *per se* illegal whereas the latter is judged under the rule of reason.

This divergent treatment is particularly ironic because to the extent that there is a difference in economic effect between the practices it is that minimum RPM permits *more* competition. As noted, both practices eliminate intrabrand price competition. Minimum RPM, however, unlike exclusive territories, permits intrabrand non-price competition. Moreover, it leaves multiple sellers of the brand in the same geographic market to engage in interbrand competition.

Minimum RPM also may be the more efficient means of solving the free-rider problem. For example, a manufacturer may find it most efficient to have one dealer on each side of a city, because some (but not all) customers shop only on their side of a city. The free-rider problem created by those customers who would travel to the other side for a lower price could be solved by giving one dealer an exclusive territory covering the entire city, but that solution would be inefficient in that it would forsake those consumers who would not travel across town to the remaining dealer. As compared to the use of minimum RPM to solve the free-rider problem, both the manufacturer and consumers would be worse off.

Amici submit that the Court, therefore, ought to grant the petition in this case in order to reconcile the standards applicable to price and non-price restraints. There is, to be sure, economic value in precedent. By its nature, however, antitrust is intended to evolve along with economics learning and, as *GTE Sylvania* and *Khan* demonstrate, the Court has not hesitated to abandon decisions whose economic

underpinning has been eroded and whose continued existence impedes, as opposed to advances, economic efficiency and consumer welfare. *Amici* respectfully submit that the rule in *Dr. Miles* cannot be reconciled with this Court's analysis in *GTE Sylvania*. By far, a more appropriate rule is to evaluate vertical minimum resale price agreements under the traditional rule of reason standard.

CONCLUSION

For the foregoing reasons, the Court should grant the Petition for a Writ of Certiorari and should overrule the *per se* rule against minimum RPM.

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FILED
NOV - 3 2006
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as
Kay's Kloset . . . Kay's Shoes,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF *AMICI CURIAE* ECONOMISTS IN SUPPORT OF PETITIONER

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MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Pursuant to this Court's Rule 37.2(b), a group of distinguished economists (listed in the Appendix to the proposed brief) respectfully requests leave of this Court to file the attached brief as *amici curiae* supporting Petitioner. Petitioner has consented to the filing of this brief, but Respondent has withheld such consent, thus necessitating the filing of this motion.

The proposed *amici* are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Nine of them have served as either the Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice.

They submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the case to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

Based on the foregoing, proposed *amici* hereby move for leave to file this brief *amici curiae* in support of Petitioner.

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November 3, 2006

QUESTION PRESENTED

Should minimum resale price maintenance continue to be deemed *per se* unlawful under Section 1 of the Sherman Act, or, in light of modern economic understanding and antitrust policy, should it instead be subject to the rule of reason, like other vertical price and non-price restraints?

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INTEREST OF *AMICI CURIAE*[1]

Amici, who are listed in the Appendix hereto, are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Nine of the *amici* have served as either the Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency).

Amici submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the question presented; and to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

INTRODUCTION AND SUMMARY

The petition in this action addresses the antitrust treatment of minimum resale price maintenance ("RPM") agreements in which an upstream seller agrees with a buyer on the minimum price, or the exact price, at which the buyer will resell the goods. Minimum RPM has been treated as *per se* unlawful under Section 1 of the Sherman Act, 15 U.S.C. § 1, since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), except for the years 1937 to 1975

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[1] *Amici* file this brief solely as individuals, and not on behalf of any institutions or organizations with which they are affiliated. No counsel for a party has authored this brief in whole or in part and no person or entity, other than *amici* or their counsel, has made a monetary contribution to the preparation or submission of this brief.

when it was partially exempted from the Sherman Act by statute. *See* Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 3-7 (Bureau of Econ., Fed. Trade Comm'n 1983). Other vertical restraints, including maximum RPM, in which a buyer and seller set a ceiling on the buyer's resale price, as well as almost all non-price vertical agreements, are now analyzed under the rule of reason, although they had previously been considered *per se* illegal. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum RPM); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical non-price agreements generally).

Amici urge the Court to grant the Petition for Writ of Certiorari in this case and, ultimately, determine that minimum RPM is subject to analysis under the rule of reason, rather than being illegal *per se*. This Court has frequently observed that the rule of reason is the presumptive standard for determining the legality of practices challenged as anticompetitive under the Sherman Act. *Per se* condemnation is reserved for conduct that almost never has a procompetitive effect and almost always has an anticompetitive effect.

In the lengthy period since this Court decided *Dr. Miles*, economic analysis of minimum RPM agreements has demonstrated that vertical restrictions between manufacturers and their dealers, including agreements on minimum resale prices, can enhance competition. Consistent with that teaching, this Court has overruled past decisions that held non-price vertical restraints and maximum RPM unlawful *per se*. The same reasoning should now lead this Court to treat minimum RPM in the same manner, thus abandoning an anachronistic distinction that finds no support in sound economic analysis.

RPM can have procompetitive effects under some common circumstances, especially where manufacturers

seek to deter free riding on welfare-enhancing investments in services by certain retailers. Even where free riding is not an issue, minimum RPM can sometimes be an efficiency-enhancing means to enforce commitments by resellers to invest in sales effort or to manage uncertainty in demand.

The economics literature provides no basis for concluding that minimum RPM almost always produces anticompetitive effects. In many if not most cases, interbrand competition precludes a manufacturer from setting resale prices above a competitive level. And regardless of the extent of interbrand competition, a manufacturer has little incentive to enrich its dealers by inducing them to impose noncompetitive mark-ups on its products. To the contrary, manufacturers have an incentive to require minimum mark-ups that will result in enhanced levels of service to increase total sales. That is a procompetitive effect which benefits manufacturers and consumers alike. While it is possible that minimum RPM could be used in conjunction with a cartel at the manufacturer or dealer level, the economics literature does not indicate that it does so often, much less virtually all the time as would be necessary to justify a *per se* rule. Taken as a whole, the economics literature does not establish that minimum RPM satisfies this Court's strict criteria for *per se* treatment.

In *amici*'s view, moreover, it is important to bring the law governing non-price and price restraints into congruence. From an economics perspective, vertical price and non-price restraints are substantially identical in effect. Not only is there is no justification for treating the two types of restrictions in such a markedly disparate fashion where sound economic analysis fails to support the distinction, but doing so may force businesses to resort to non-price restraints in situations in which price restrictions may

provide the most effective and procompetitive way to ensure efficient conduct by dealers.

ARGUMENT

I. MINIMUM RPM DOES NOT SATISFY THIS COURT'S STANDARD FOR APPLICATION OF THE *PER SE* RULE

A. The *Per Se* Rule Should Apply Only to Conduct that Almost Never Is Procompetitive and Almost Always Is Anticompetitive

This Court has emphasized that antitrust claims are presumptively subject to rule of reason analysis and that *per se* condemnation is limited to a small class of alleged antitrust offenses whose character is well understood and that are virtually invariably harmful to competition. *See Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006). More specifically, the *per se* rule should be applied only to practices that almost invariably have no procompetitive effects and almost invariably have significant anticompetitive effects—or, as the Court has put it, that have a "pernicious effect on competition and lack . . . any redeeming virtue." *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958), *quoted in GTE Sylvania*, 433 U.S. at 58; *see also GTE Sylvania*, 433 U.S. at 50 (finding *per se* rules appropriate for "conduct that is manifestly anticompetitive"); *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979) (prescribing *per se* treatment when a "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output"). Under this formulation, there is no justification for applying the *per se* rule to minimum RPM.

B. Minimum RPM Can Be Procompetitive

RPM agreements include either a specific price at which a product must be resold or a floor below which the reseller

may not price in reselling the product. (Often, as here, the upstream seller is a manufacturer and the reseller is a retailer. Although that is not always the case, *amici* will use the terms "manufacturer" and "retailer" to denote the upstream seller and reseller, respectively.) An RPM agreement establishes a minimum mark-up for the retailer (the difference between the resale price and the wholesale price from the manufacturer).

Generally, a manufacturer wants retail margins to be low; having sold the product to the retailer, it wants the retailing function to be performed as efficiently as possible, with competing retailers, in turn, passing on to consumers the lowest price consistent with retailers' providing desired services and continuing in business. In real-world markets, however, the incentives facing retailers may be out of alignment with those of manufacturers, to the detriment of the manufacturers' ability to compete effectively with the products of competing manufacturers. In such cases, minimum RPM can help to align these incentives and enhance the competitiveness of a manufacturer's product, thereby benefiting consumers.

1. Eliminating "Free Riding"

There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.

In purchasing many products, consumers value services performed at the retail level—that is, the provision of these services increases the value of the product for consumers, and some consumers are willing to purchase the product with these services, whereas they would not be willing to

purchase the product if the services were not provided. In some situations, "the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher retail price." G. Franklin Mathewson & Ralph A. Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 67 (1998). The result is an increase in total demand and sales. In such cases, consumer welfare generally will also increase compared with the world in which the product is offered at a lower price but without the dealer's services. *See* Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* Issues in Competition Law and Policy (ABA Antitrust Section, Wayne Dale Collins ed., forthcoming 2007), *available at* http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf.

This phenomenon is likely to be most significant in cases for products that are differentiated and therefore are sold on the basis of features and quality as well as price. For example, a digital camera may require that a retailer explain its unique features and quality in order to realize its maximum sales against competing digital cameras with their own unique features, or against film cameras. Or, a fashion item such as the women's accessories at issue in this case may benefit from longer store hours, more convenient or prestigious store locations, better-trained and more enthusiastic employees, or favoritism in shelf placement. From an economics perspective, all of these services can enhance the quality (real or perceived) of the product because they demonstrably have value to consumers. In such cases, investment in retail services can make consumers, as well as manufacturers and retailers, better off.

Market imperfections, however, may lead retailers to offer less than the amount of support that would be best for manufacturers and consumers. The imperfection most

commonly discussed in the economic literature is the so-called "free-rider" problem. Free riders, in this context, are competing retailers that take advantage of the fact that a prospective customer is under no obligation to purchase the product from the retailer that invests in retail-level services. A customer may take advantage of one retailer's informed sales staff, hands-on demonstrations, and convenient shopping locations and hours. Having received the value of those services, the potential customer may then purchase the product from another retailer that does not provide the same level of service and, therefore, can afford to sell the product for less. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960); G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337 (1983). For example, a customer may inspect, try out, and learn about a particular type of digital camera at a high-end retailer but then purchase the product from a discount retailer, through mail order, or over the internet.

Free riding creates externalities that lead each retailer—and thus retailers collectively—to spend less on service than is optimal. Each retailer's incentive is to invest in service only to the extent that the additional service costs are recouped through *its* increased sales. Some of the increased sales go to the free-riding retailers, and the full-service retailer properly ignores them when computing its gain from spending more on service. It thus spends less on service than would maximize total sales of the manufacturer's product.

Free riding can also take place where the thing of value provided by the higher-priced retailer is not services, but quality "signaling." *See* Overstreet, *supra*, at 56. Some retailers build a reputation for carrying high-quality or cutting-edge merchandise. Building such a reputation requires an investment, not only in product lines, but in the store's reputation through advertising, location, and other

expenditures. *See* Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974). These investments in quality signaling also have the potential to be free-ridden upon: consumers can observe that a brand is sold in a store that they believe would sell only high-quality merchandise and, having concluded that the product is therefore of high quality, purchase it at a discount retailer that also carries it. Minimum RPM in this situation, just as in the services context, can protect the investment of the quality-signaling retailer and help ensure that this retailer can continue to fulfill this function, which for some products is of value both to consumers and to manufacturers and enhances interbrand competition. *See* Overstreet, *supra*, at 56-62.

Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do. By mandating a minimum resale price, the manufacturer can calibrate the level of services offered by retailers to the level at which the manufacturer's profits are maximized (which, once the manufacturer has set its price, is when the greatest amount of output is sold). In some instances, full-service retailers may actually charge less under minimum RPM, because they will be assured of more volume that otherwise would have gone to free-riding discounters. In the long run, minimum RPM thus may "reduce the maximum, and possibly the average, price charged" for the product. Mathewson & Winter, *supra*, 21 Econ. Inquiry at 347. Where free riding exists, minimum RPM arrangements generally increase overall consumer welfare. *See id.*; *see also* Elzinga & Mills, *supra*, manuscript at 7-9 (discussing the conditions under which minimum RPM may increase or decrease total welfare). One reason for the likely net procompetitive effect is that, as explained below, manufacturers have strong incentives to avoid prescribing resale prices that increase retailer margins without inducing them to provide desired retail services.

Minimum RPM is not the only method by which manufacturers can address free-riding concerns, but under some circumstances it may be the only practical one or the most competitive one. There are three principal ways other than RPM to address free riding. First, manufacturers can contract with retailers for specific services. However, the nature of marketing and selling is such that it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them. It is also possible that the retailer, rather than the manufacturer, knows which retail-level services will be most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer. Alternatively, manufacturers could charge consumers directly for point-of-sale services. However, that normally is not practical because the services provided by retailers frequently are informational or because there are economies of scale or scope that retailers which sell a range of products can take advantage of, thereby reducing their cost of providing such services. Finally, a manufacturer might use non-price vertical restraints (such as exclusive territories) to preclude *all* competition from free riders. As discussed below, this alternative is more restrictive of competition and perhaps less efficient than minimum RPM.

2. *Ensuring Dealer Contribution to Product Quality*

Even absent free riding, retailers may not be inclined to make the level of investments in service that would maximize the overall competitiveness of a manufacturer's products. According to Klein and Murphy, minimum RPM can help ensure a desired level of investment in retail services. A manufacturer can threaten to terminate a dealer that provides inadequate service, but given the difficulties of

monitoring service levels a retailer may be willing to bear the risk of termination rather than incur the cost of providing additional services. It may be less inclined to do so where the risk it faces is losing an RPM-enhanced margin. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265, 265-70 (1988); *see also* Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597 (1993) (applying the Klein-Murphy theory to RPM cases litigated before the advent of modern economic thought about vertical restraints).

With minimum RPM, retailers' choice of value-added services are determined and disciplined by market competition with other retailers. By eliminating intrabrand price competition among dealers, minimum RPM effectively shifts intrabrand competition to the non-price arena—that is, retailers compete to find the service package that best drives sales of the product. Elzinga & Mills, *supra*, manuscript at 4. This competition benefits consumers, who receive the package of retail-level services most useful to them; benefits retailers that develop the package, and thereby compete successfully against other retailers selling either the same or different products; and benefits the manufacturer, whose sales thereby increase.

3. Managing Demand Uncertainty

There is also support for the proposition that RPM can help to stabilize demand for a product where retailers must order their inventories of the product before demand for it is known. *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997). If demand proves unexpectedly low after retailers have acquired a substantial inventory, prices can plummet as retailers liquidate their holdings. By preventing this precipitous decline, minimum RPM can benefit consumers

by encouraging retailers to maintain appropriate inventory levels. Knowing that RPM provides them with some protection in case demand is low, dealers may be willing to place larger orders in advance of knowing the demand, thereby ensuring adequate stocks if demand turns out to be high. Similarly, dealers may be more willing to invest in inventory in more innovative and risky products or styles, which can enhance product variety and benefit competition and consumers.

C. The Economics Literature Does Not Support the Conclusion that Minimum RPM Often, Much Less Invariably, Has an Anticompetitive Effect

1. Minimum RPM's Enhancement of Interbrand Competition Offsets Its Effect on Intrabrand Competition

Minimum RPM inherently restrains intrabrand price competition (competition among resellers of the brand that is the subject of the agreement). As this Court has recognized, however, the principal form of competition that the antitrust laws encourage is interbrand competition (competition among the products of different manufacturers). *See, e.g.*, *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724-26 (1988); *GTE Sylvania*, 433 U.S. at 54-55. As noted above, the manufacturer that uses minimum RPM can enhance interbrand competition by causing resellers to provide additional services that will increase the product's competitiveness against other products and increase sales of the product. Thus, even where minimum RPM raises the price charged by a given retailer, that does not mean that there is necessarily an anticompetitive effect. *See Sharp*, 485 U.S. at 728.

In a world of imperfect information, it is, of course, possible that a manufacturer will erroneously prescribe minimum resale prices that are higher than optimal and that

will lead to lower, not higher, sales. But the manufacturer has incentives to avoid doing so. It gains no profits from having its dealers charge excessive prices or furnish unwanted service. To the contrary, where the prescribed resale price exceeds the level that optimizes the sales of the brand, the manufacturer is the loser, just as it is where the price is below the optimal level. In the ordinary case, therefore, manufacturers will strive to avoid setting resale prices above what the market calls for. In all events, it is not the function—or capacity—of antitrust law to prevent such errors. That is what markets are for. *See* Elzinga & Mills, *supra*, manuscript at 9 (citing Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981)); *see also* Frank H. Easterbrook, *Contract and Copyright*, 42 Hous. L. Rev. 953, 957 (2005) ("Markets are *much* better than judges at sifting efficient from anticompetitive practices." (emphasis in original)).

2. *The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Manufacturer Cartels*

One objection to minimum RPM that had some traction historically is that it might be used to facilitate a cartel at the manufacturer level. There is no reason to believe, however, that this occurs frequently, or that a *per se* rule is needed to address any cases in which it does occur.

Most cartels do not involve manipulation or control of downstream resale prices, but minimum RPM has been proposed as one means by which a cartel can dissuade cheating by its members, which have incentives to reduce prices slightly and thereby gain market share. Cartel members seeking to prevent "cheating" on their agreement ideally would observe each other's prices directly. Market circumstances or prudence, however, may preclude that from happening. As an alternative, manufacturers might agree to

impose RPM agreements on their dealers, so that any reduction in price by a manufacturer could not be passed on to the consumer by the retailer, but would enrich only the retailer. With no benefit to consumers, demand for the product would not increase, and the would-be "cheat" would not benefit from its reduced prices.

There are reasons to believe that this type of use of minimum RPM would not be very common.

First, this situation could arise only where manufacturers had agreed to a criminal cartel and where market conditions made such a cartel practical. Thus, it would not apply where a manufacturer is law-abiding or where the number of competing manufacturers, the ease of entry, or other market circumstances rendered a successful cartel implausible. *See* Overstreet, *supra*, at 19-23. *See generally* George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964) (discussing prerequisites for effective horizontal coordination); U.S. Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* §§ 2.11, 2.12 (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 2, 1992) (same).

Second, it would not apply where compliance with a conspiracy can be monitored without RPM. It is noteworthy that minimum RPM has not been generally reported as an enforcement mechanism in the major price-fixing cartels that the Department of Justice has prosecuted in the past decade.

Third, there is no empirical evidence that minimum RPM is used with any frequency in this manner. To the contrary, the empirical evidence that does exist suggests that such use of minimum RPM is not common. In 1991, Pauline Ippolito of the Federal Trade Commission reported a study of the frequency with which both manufacturer cartels and retailer cartels (discussed below) were alleged in the 153 reported minimum RPM cases from 1976 to 1982. *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence*

from Litigation, 34 J.L. & Econ. 263 (1991). Ippolito found that only 5.9 percent of the cases involved allegations of horizontal manufacturer price fixing in addition to RPM. She concluded, "[o]n this basis, there is little evidence . . . to support the hypothesis that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM." *Id.* at 281.

3. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Reseller Cartels

It also has been suggested that minimum RPM could be used to facilitate reseller cartels. *See* Basil S. Yamey, *Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade*, 62 Econ. J. 522 (1952). Retailers that sought to form a cartel could induce manufacturers to implement minimum RPM agreements and thereby become the cartel's enforcement mechanism.

For many of the reasons mentioned above with respect to manufacturer conspiracies, the use of minimum RPM to enforce dealer cartels is not likely to be very common. Such a situation would require a retail market with high barriers to entry, because manufacturers would otherwise sell through non-colluding, lower-margin dealers. Cartelization is also an unlikely motive in markets where only one or few competitors implement RPM programs because otherwise consumers could switch to brands not encumbered by collusive retail margins. Moreover, because dealers often can observe each other's prices directly, participation by suppliers in such a cartel through minimum RPM agreements is unlikely to be necessary.

In addition, the manufacturer—a key element in these agreements—receives no benefit from a dealer cartel, but on the contrary, suffers diminished sales. Therefore,

manufacturers generally lack incentives to cooperate in furthering a dealer cartel.

As with manufacturer cartels, the empirical evidence lends no support to the suggestion that minimum RPM often facilitates retailer cartels. In Ippolito's 1991 study, only 7.2 percent of the 153 minimum RPM cases reported between 1976 and 1982 contained allegations of collusion among dealers. This contributed to Ippolito's conclusion that "this evidence suggests that, on the margin, a relaxation of the *per se* rule against RPM would primarily affect noncollusive uses of RPM." Ippolito, *supra*, 34 J.L. & Econ. at 282. Overstreet, in a 1983 survey of litigated FTC minimum RPM cases, found that of the 47 cases between 1965 and 1982 for which information was available on retail market structure, 43 involved at least 100 competing retailers, a situation in which "[w]idespread dealer collusion . . . seems unlikely to be effective or persistent" absent certain market conditions. Overstreet, *supra*, at 80. He observed that "[i]t seems reasonable to conclude that for the majority of these (47) cases the use of RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel." *Id.*

4. The Disagreements in the Economics Literature Provide No Basis for a Per Se *Rule*

There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects. Upon careful scrutiny, however, it is apparent that the range of the disagreements underscores that a rule of *per se* illegality should not be applied to minimum RPM.

In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature

relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue. The critical issue is the boundaries of that dispute. Some believe that minimum RPM is almost always benign and thus should basically be ignored by antitrust law. *See, e.g.*, James C. Cooper et al., *Vertical Antitrust Policy as a Problem of Inference* (Vanderbilt Univ. Law Sch., Law & Econ. Working Paper 05-12, Feb. 18, 2005), *available at* http://ssrn.com/abstract=699601. Others believe that RPM has been demonstrated to be anticompetitive in some cases and thus merits serious antitrust consideration. *See, e.g.*, F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Competition Pol'y Int'l 65 (2005); William S. Comanor et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* (Am. Antitrust Inst. Working Paper No. 05-04, Apr. 18, 2005), *available at* http://www.antitrustinstitute.org/recent2/408.pdf. The position absent from the literature is that minimum RPM is most often, much less almost invariably, anticompetitive. Thus, the economics literature provides no support for the application of a *per se* rule.

II. RULE OF REASON TREATMENT OF MINIMUM RPM IS NEEDED TO MAINTAIN DESIRABLE CONSISTENCY BETWEEN PRICE AND NON-PRICE RESTRAINTS

Antitrust law has moved steadily in the direction of evaluating vertical restraints under the rule of reason, and appropriately so. Maximum RPM and all forms of vertical non-price restraints (except, nominally, some tying arrangements) are now subject to assessment under the rule of reason.

Applying the rule of reason to minimum RPM, like almost all other vertical restraints, is appropriate because there is little difference in economic substance between price

and non-price restraints. Compare minimum RPM, for example, to territorial exclusivity. Like minimum RPM, exclusive territories relieve dealers of being in price competition with each other as to the same brand of product. Yet, under the present state of the law the former is *per se* illegal whereas the latter is judged under the rule of reason.

This divergent treatment is particularly ironic because to the extent that there is a difference in economic effect between the practices it is that minimum RPM permits *more* competition. As noted, both practices eliminate intrabrand price competition. Minimum RPM, however, unlike exclusive territories, permits intrabrand non-price competition. Moreover, it leaves multiple sellers of the brand in the same geographic market to engage in interbrand competition.

Minimum RPM also may be the more efficient means of solving the free-rider problem. For example, a manufacturer may find it most efficient to have one dealer on each side of a city, because some (but not all) customers shop only on their side of a city. The free-rider problem created by those customers who would travel to the other side for a lower price could be solved by giving one dealer an exclusive territory covering the entire city, but that solution would be inefficient in that it would forsake those consumers who would not travel across town to the remaining dealer. As compared to the use of minimum RPM to solve the free-rider problem, both the manufacturer and consumers would be worse off.

Amici submit that the Court, therefore, ought to grant the petition in this case in order to reconcile the standards applicable to price and non-price restraints. There is, to be sure, economic value in precedent. By its nature, however, antitrust is intended to evolve along with economics learning and, as *GTE Sylvania* and *Khan* demonstrate, the Court has not hesitated to abandon decisions whose economic

underpinning has been eroded and whose continued existence impedes, as opposed to advances, economic efficiency and consumer welfare. *Amici* respectfully submit that the rule in *Dr. Miles* cannot be reconciled with this Court's analysis in *GTE Sylvania*. By far, a more appropriate rule is to evaluate vertical minimum resale price agreements under the traditional rule of reason standard.

CONCLUSION

For the foregoing reasons, the Court should grant the Petition for a Writ of Certiorari and should overrule the *per se* rule against minimum RPM.

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1/27/06

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . .
Kay's Shoes,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

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IN THE

Supreme Court of the United States

No. 06-480

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . .
Kay's Shoes,
Respondent.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Pursuant to Supreme Court Rule 37.2, the National Association of Manufacturers (NAM) moves for leave to file the attached brief *amicus curiae* in support of the petition. The Petitioner has consented to the filing of this brief. The Respondent has not, necessitating this motion.

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media, and the general public about the vital role that manufacturing plays in America's economic future and living standards.

The NAM's members face competition from domestic and foreign rivals, and thus have an abiding interest in the standards used to judge the legality of competitive practices. Indeed, because many of the NAM's members introduce their products into the marketplace through independent dealers, the NAM has a great concern about *per se* antitrust rules that stifle service and promotional programs that ultimately benefit consumers.

The NAM accordingly submits this brief in support of the petition because it presents a rare opportunity for this Court to reevaluate the utility of the *per se* rule against minimum resale price maintenance announced in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). In the 95 years since that case was decided, subsequent courts, including this one, have sought to soften its blow by elevating formal distinctions above antitrust substance—an awkward and illogical end-run around the *Dr. Miles* rule. In particular, because *Dr. Miles* precludes courts from evaluating the competitive effects of a vertical price restraint, courts instead have focused their attention on whether any agreement to fix prices exists, rather than on evidence of consumer harm caused by a given vertical price restraint. The unsurprising byproduct of an analytical inquiry focused exclusively on the agreement or conspiracy element required for a Sherman Act Section 1 claim is an incoherent body of vertical restraints law that produces different results in cases with identical potential impact on consumers. This incoherence in turn forces manufacturers like the members of the NAM to walk a precarious line in their relationship with the dealers that distribute their products, with aggressive pro-competitive strategies that serve consumer welfare on one side—and treble damages on the other.

With its brief, the NAM seeks to contribute to the Court's understanding of the harmful distortions *Dr. Miles* has worked in the law of vertical restraints and the profound consequences those distortions continue to create for manufacturers in a fiercely competitive marketplace. Accordingly, the NAM respectfully requests that the Court

grant its motion for leave to file the attached brief *amicus curiae* in support of the petition.

Respectfully submitted,

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BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

STATEMENT OF INTEREST OF AMICUS CURIAE

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media, and the general public about the vital role of manufacturing in America's economic future and living standards.

The NAM has participated in a number of cases before this Court, including cases involving antitrust issues. *See Weyerhaeuser Co.* v. *Ross-Simmons Hardwood Lumber Co., Inc.*, No. 05-381 (2006); *Volvo Trucks North Am., Inc.* v. *Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006); *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997); *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717 (1988); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984). And the NAM has a great interest in the question presented by the petition—whether vertical minimum resale price maintenance agreements should constitute *per se* antitrust violations, or whether they instead should be reviewed under the rule of reason—because the answer to that question has enormous practical importance for its members around the country.

The members of the NAM include numerous manufacturers that rely on independent dealers for distribution of their products to consumers. As a consequence of the inflexible *Dr. Miles* rule prohibiting manufacturers from agreeing on resale prices with the dealers who deliver their products to the consumer marketplace, this Court and lower courts have focused their attention on whether a manufacturer and its dealers have agreed to fix prices, rather than on whether a given vertical price restraint enhances or harms consumer welfare. The formalistic distinctions resulting from this myopic focus have unfortunately produced an inconsistent and arbitrary body of vertical restraints precedent that does not even facially implement the purposes of the antitrust laws. This state of affairs compels the NAM's members to focus on technical distinctions rather than economic realities as they attempt to reach arrangements with their dealers that will permit them to compete effectively in the marketplace but will not at the same time constitute an antitrust violation with a concomitant treble damages sanction.

The NAM thus offers this brief because of the critical stake its members have in ensuring that they can legally enter into

arrangements with dealers to enhance inter-brand competition and ultimately to benefit consumers.[1]

SUMMARY OF ARGUMENT

Nearly a century ago, in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court announced a *per se* rule against vertical price restraints. Since then, *Dr. Miles* has proven to be "one decisive misstep that has controlled a whole body of law." Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* 32 (Free Press 1993). With that case, "the law of resale price maintenance * * * has been rendered mischievous and arbitrary to this day by the premise laid down there." *Id.*

Dr. Miles has wreaked havoc not just in the law of resale price maintenance. Almost immediately after it was announced, this Court and the lower courts began to seek ways to cabin its reach. But they have done so only by tinkering with another area of antitrust law—namely, the standard for determining whether an "agreement" to restrain trade exists under Section 1 of the Sherman Act. *See* 15 U.S.C. § 1. Because the *per se* rule of *Dr. Miles* forecloses all inquiry into the competitive effects of resale price maintenance, courts have focused their attention on evidence of "agreement," rather than on the harm—or benefit—to consumers from a given practice. But as this Court has explained, "the primary purpose of antitrust laws is to protect interbrand competition," *State Oil Co.* v. *Kahn*, 522 U.S. 3, 15 (1997) (citing *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988)), not to regulate manufacturer-dealer relationships.

The consequence of this persistent distraction from the proper aim of antitrust has been the emergence of a body of

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[1] No counsel for any party authored this brief in whole or in part, and no person or entity, other than amicus curiae and its members, made a monetary contribution to the preparation or submission of this brief. S. Ct. Rule 37.6.

law that is contradicted by the plain economic realities of modern commercial life and that has necessarily produced divergent results in cases involving identical competitive harms. The distortions caused by *Dr. Miles* also have thrust the law of vertical price restraints into irreconcilable tension with the Court's modern antitrust jurisprudence, which is firmly rooted in sophisticated economic analysis.

This petition affords the Court an opportunity to correct the misstep in *Dr. Miles*, and in the process dispel the resulting deep inconsistencies in its antitrust jurisprudence, bring its doctrine in line with sound economic and antitrust policy, and refocus lower courts on the proper aim of antitrust law—to protect consumers from anticompetitive practices. The Court should take this opportunity, grant the petition, and give *Dr. Miles* a proper and long overdue burial.

The end of *Dr. Miles*, to be clear, will not render all vertical price restraints *per se lawful*. Rather, it will only make resale price maintenance arrangements between manufacturers and dealers subject to the time-tested rule-of-reason analysis, which allows courts to carefully weigh the competitive benefits and harms of a given arrangement. This Court has explicitly held that this approach is the proper default standard for assessing alleged antitrust violations absent economic justification warranting some deviation from that rule.

ARGUMENT

I. THE PETITION PROVIDES THE COURT AN OPPORTUNITY TO ELIMINATE A STRIKING ANACHRONISM FROM ITS MODERN ANTITRUST JURISPRUDENCE.

The question presented in this case is whether this Court should reconsider the *per se* restriction on vertical minimum resale price maintenance that *Dr. Miles* announced nearly a century ago in reliance on a common law prohibition against "general restraint[s] upon alienation." 220 U.S. at 404; *see also United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365,

380 (1967). The answer to that question is yes. The rule announced in *Dr. Miles* is a relic of an era in antitrust law that has long outlived its usefulness.

In its seminal decision in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 47 (1977), this Court announced that "[r]ealities must dominate the judgment" of alleged restraints of trade and that "[t]he Anti-Trust Act aims at substance." With those statements the Court began a steady march toward a rule-of-reason approach rooted in conventional economic analysis. As the Court explained in *Sylvania*, any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing." *Id.* at 58-59.

The Court indeed has not hesitated to overrule even relatively recent precedent in service of that directive, recognizing that in the area of antitrust it must "adapt[ ] to changed circumstance[s]," apply "the lessons of accumulated experience," and reconsider decisions when their "theoretical underpinnings * * * are called into serious doubt." *State Oil*, 522 U.S. at 20-21. Thus, in *State Oil*, the Court held maximum resale price restraints subject to the rule of reason, despite having held them *per se* invalid barely a quarter of a century earlier in *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968). And in *Sylvania*, the Court held non-price vertical restraints subject to rule-of-reason analysis, even though it had subjected them to *per se* treatment only ten years earlier in *Schwinn*, 388 U.S. 365.

The *per se* rule recognized in *Dr. Miles* is of far earlier vintage than those abandoned precedents. Indeed, unlike *Albrecht* and *Schwinn*, the rule of *Dr. Miles* was adopted a month before this Court first recognized any form of the rule of reason, *see Standard Oil Co. of New Jersey* v. *United States*, 221 U.S. 1 (1911). As with *Albrecht* and *Schwinn*, *Dr. Miles*'s day has come.

The "great weight of scholarly opinion" has condemned *Dr. Miles*' *per se* prohibition on vertical minimum resale price maintenance arrangements. *Sylvania*, 433 U.S. at 47-48. The petition amply demonstrates the harsh treatment the rule

has received over the years at the hands of judges, economists and legal scholars. *See* Pet. 11-16. These criticisms are sound, and there is no need to recapitulate them here.

The NAM instead devotes the bulk of the following pages to a discussion of the continuing anachronisms in the law of conspiracy that have resulted from courts' efforts to apply—or indeed avoid applying—*Dr. Miles*'s outmoded *per se* ban on vertical minimum resale price maintenance arrangements in the modern commercial setting.

II. THE HARMFUL EFFECTS OF *DR. MILES* ARE NOT CONFINED TO THE RESALE PRICE MAINTENANCE CONTEXT.

Because it rendered all vertical price restraints *per se* unlawful, *Dr. Miles* has played havoc in the law of vertical restraints by affirmatively preventing courts from analyzing whether such vertical price restraints are consistent with the purpose of antitrust law to facilitate inter-brand competition. Instead of examining whether a vertical minimum resale price maintenance arrangement actually harms consumers, *Dr. Miles* restricts courts to a highly formalistic inquiry into whether a given manufacturer-dealer arrangement constitutes an agreement on prices. Because the approach required by *Dr. Miles* is at odds with economic principles this Court has embraced in other contexts, it has also necessarily placed the vertical price restraints doctrine in deep tension with other areas of this Court's antitrust jurisprudence. Specifically, *Dr. Miles* has worked significant mischief in courts' more general efforts to determine whether an agreement exists at all under Section 1 of the Sherman Act.

A. *Dr. Miles* Has Distorted The Standards For Determining The Existence Of A Conspiracy.

The Court's efforts to limit *Dr. Miles*'s reach commenced not long after *Dr. Miles* issued. In *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919), the Court carved out an exception to *Dr. Miles* by affirming a manufacturer's right to announce a unilateral resale pricing policy and to enforce that

policy by refusing to do business with a dealer that will not follow it. While the Court sensibly vindicated a manufacturer's basic right to choose its dealers, *Colgate* necessarily distorted ordinary principles of contract law, under which an agreement may be formed by an offer and subsequent performance—not explicit acceptance.

Legal scholars and courts alike have recognized the deformation of contract principles that *Colgate* produced as a byproduct of its attempt to blunt the force of *Dr. Miles*. Judge Posner has explained, for example, that "if a manufacturer distributes a price list, together with an announcement that he will cut off dealers who sell below the list price, and dealers adhere to those prices because they don't want to be cut off, there is a realistic sense in which the threat of termination has induced the dealer to agree not to cut prices—to agree, in other words, to fix prices." *Isaksen* v. *Vermont Castings, Inc.*, 825 F.2d 1158, 1164 (7th Cir. 1987).

Scholars with varied perspectives similarly have stressed that the clinical approach to the agreement prong of a Sherman Act Section 1 claim required by *Colgate* necessarily produces inconsistent results. This is because *Colgate* effectively requires courts to forgo an assessment of the harm, if any, caused by an alleged vertical agreement in restraint of trade, in favor of an inquiry into whether there is sufficient evidence that an agreement exists in the first place. Thus, as two noted commentators have explained, "[i]f * * * the *Colgate* case is aggressively applied, courts will reach inconsistent results in cases with identical competitive injuries" because "[a] premium would be placed upon a plaintiff's ability to make an evidentiary showing that does not further analysis of the injury caused by the restraint." Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* 325 (2000). The same commentators concluded that "[a] sound policy approach to distribution restraints emphasizes economic policy, not a sterile debate over whether a conspiracy or agreement exists." *Id.* But the law today instead requires a focus on the "agreement."

The Court's effort in *Colgate* to mitigate the error of *Dr. Miles* thus only compounded the problem. In *United States* v. *Parke, Davis, & Co.*, 362 U.S. 29, 47 (1960), the Court narrowed the rule it announced in *Colgate* by holding that the rule did not apply (and therefore that *Dr. Miles did* apply) if the manufacturer took "affirmative action to achieve uniform adherence" to its resale policy. Unlike dealers' "voluntary acquiescence" in a manufacturer's policy, the Court reasoned, affirmative action by a manufacturer interfered with a dealer's free choice and necessarily involved the assistance of other dealers in enforcing the policy—which constituted forbidden concerted action. *Id.* As a result of this distinction between voluntary acquiescence and coercion, evidence of *disagreement* between a manufacturer and dealer may thus actually signal an *agreement* to fix prices. *Cf. Isaksen*, 825 F.2d at 1163 ("[A]n agreement procured by threats is still an agreement for purposes of section 1.").

Since *Parke, Davis*, the Court has made it more difficult to prove *per se* illegal vertical agreements in some circumstances, *see Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717 (1988) (agreement between manufacturer and one dealer to terminate price-cutting dealer not *per se* unlawful under *Dr. Miles* unless manufacturer and remaining dealer agree on resale price or price level); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 768 (1984) (requiring "evidence that tends to exclude the possibility of independent action by the manufacturer and distributor" and "reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective"), but these decisions have failed to mitigate the rigid formalism inherent in the basic inquiry. And the primacy the *Dr. Miles* rule (operating in conjunction with the *Colgate* doctrine) places on evidence of an agreement continues to plague the lower courts today.[2] In their effort to

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[2] *See, e.g., Center Video Indus. Co.* v. *United Media, Inc.*, 995 F.2d 735, 736 (7th Cir. 1993) (no concerted activity where video editing equipment dealer complained to manufacturer about

steer between *Colgate* and *Dr. Miles*, lower courts are driven to apply strained interpretations of contract law, while failing to address economic realities.

For example, in *The Jeanery, Inc.* v. *James Jeans, Inc.*, 849 F.2d 1148 (9th Cir. 1988), the court concluded that there was insufficient evidence of a conspiracy for the plaintiff, a jeans retail outlet store, to submit its vertical price-fixing claim against the manufacturer to a jury. *Id.* at 1161. The court reached this result even though the manufacturer had made it abundantly clear to its dealers that it expected them to charge a "keystone" retail price for its jeans—*i.e.*, a two-fold

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discounting dealer, manufacturer requested discounting dealer to "raise the company's prices," manufacturer later terminated the discounting dealer and, on its termination, complaining dealer raised its prices "higher than the prices that it was charging while in competition" with discounter); *Parkway Gallery Furniture, Inc.* v. *Kittenger/Pennsylvania House Group*, 878 F.2d 801, 801-803 (4th Cir. 1989) (no concerted activity where furniture manufacturer adopted policy "prohibit[ing] its dealers from soliciting or selling its furniture by mail or by telephone to consumers residing outside specified areas of retail responsibility" in consultation with its dealers and in response to their complaints about discount dealers, manufacturer solicited dealer reactions to its policy, some dealers expressed agreement with policy and indicated they would abide by it, and one dealer notified manufacturer of "a violation [of the policy] and sought enforcement"); *see also Glacier Optical, Inc.* v. *Optique Du Monde*, 46 F.3d 1141 (9th Cir. 1995) (insufficient evidence of concerted action where dealers complained to supplier about discounters, supplier threatened to terminate discounters and monitored and investigated sales to discounters); *Holabird Sports Discounters* v. *Tennis Tutor, Inc.*, 993 F.2d 228 (4th Cir. 1993) (insufficient evidence of concerted action where manufacturer had policy against selling to dealers that advertised product for less than suggested retail price, monitored violations of the policy, and terminated non-complying dealer); *see generally* 1 *ABA Section of Antitrust Law, Antitrust Law Developments (Fifth)* 18-19 n.87 (ABA 2002).

markup of the wholesale price charged to the retailers—and that it would either terminate or deal less favorably with dealers that refused to charge the "keystone" price. *Id.* at 1150. This would obviously be considered concerted action in another context. But the Ninth Circuit rationalized that "this evidence [was] insufficiently probative of a conspiracy to permit the case to go to a jury," *id.* at 1157, because it did "not support a reasonable inference of concerted behavior," *id.* at 1161.

Similarly, in *Euromodas, Inc.* v. *Zantella*, 368 F.3d 11 (1st Cir. 2004), the First Circuit held that the plaintiff dealer—a retail men's clothing store—failed to adduce sufficient evidence "reflect[ing] a commitment on [the clothing manufacturer's] part to a minimum retail price maintenance scheme." *Id.* at 19. But there was evidence that when another retail men's store complained that the plaintiff was underselling it by sharply discounting the price of certain trousers, the manufacturer provided assurances that it would "take care of" the problem—and did so by terminating the relationship with the price-cutting dealer. *See id.* at 18-19. Rather than zeroing in on the question whether the termination of the price-cutting dealer was prompted by a breach of an actual agreement to fix the resale price of trousers, it would have been more consistent with the guiding purposes of antitrust law if the court had been permitted to consider whether the manufacturer's decision to retain one dealer and terminate another harmed or benefited consumers in the long run. Had the court been able to do so, its ultimate conclusion may well have been the same—but the decision would have been rooted in antitrust substance, rather than antitrust formalism. *Dr. Miles* precludes any such inquiry, however.

The formalistic approach spawned by *Dr. Miles* also undercuts the effectiveness of corporate compliance efforts. Counselors for manufacturers have to focus on whether communications with dealers contain language that could be construed as a verbal agreement, to the detriment of a proper focus on competitive effects.

The Court should take the opportunity presented by the petition to relieve lower courts and compliance counselors of the obligation to perform the sort of strained contract analysis evident in these cases—gymnastical inquiries that have created deep inconsistencies among decisions in this area of law.

B. The Distinctions Produced By *Dr. Miles* Are Directly Contrary To Economic Principles Endorsed By This Court.

The *Dr. Miles* rule has not only spawned a series of illogical and conflicting precedents; it is fundamentally inconsistent in multiple respects with the principles that animate *Sylvania*, in which this Court announced that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing." 433 U.S. at 58-59.

To begin with, following *Sylvania*, vertical *non*-price restraints are no longer *per se* unlawful, but are instead judged according to the rule of reason. While *Sylvania* preserved the *per se* rule for vertical minimum resale price restraints—finding that this form of trade restraint "involve[d] significantly different questions of analysis and policy"—there is no practical economic reason why vertical non-price restraints and vertical price restraints should be subject to disparate treatment. 433 U.S. at 51 n.18. Vertical restraints of any kind can be expected to affect price. Indeed, this Court itself noted in *Sharp* that "*all* vertical restraints * * * have the potential to allow dealers to increase 'prices' and can be characterized as intending to achieve just that." 485 U.S. at 728 (emphasis added). Yet such restraints "only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand competition to the point where the dealer's profit margin permits provision of the desired services." *Id.*

In fact, an outright agreement on resale price may not even have as great an effect on intra-brand competition as a non-price restriction. A vertical agreement on price eliminates only one form of intra-brand competition; an exclusive sales

territory or forward integration—non-price restrictions—prevent all forms of intra-brand competition. The result: strategies that *entirely prevent* intra-brand competition may be lawful, but strategies that only *limit* intra-brand price competition are never lawful. *Cf. id.* at 725 ("[T]he *per se* illegality of vertical restraints would create a perverse incentive for manufacturers to integrate vertically into distribution, an outcome hardly conducive to fostering the creation and maintenance of small businesses.").

This distinction has practical consequences in concrete cases—and courts have been forced to employ extreme intellectual ingenuity to avoid its implications. In *Eastern Scientific Co.* v. *Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir. 1978), for example, the First Circuit declined to place an acknowledged price restraint in the *Dr. Miles per se* category because it only applied to sales outside the dealer's assigned territory. The court of appeals rationalized that "[i]t may be true that defendant's policies here appear in form to *resemble resale price maintenance agreements*," but nonetheless concluded that "we are unable to conceive of how the resale price restrictions used to enforce the assigned territories in the present case can possibly have a greater anti-competitive effect than a pure policy of territorial restrictions." *Id.* at 885 (emphasis added).

Dr. Miles is also at odds with one of *Sylvania*'s fundamental insights. *Dr. Miles* was predicated, in part, on the premise that vertical price arrangements were tantamount to horizontal agreements among dealers. *See Dr. Miles*, 220 U.S. at 408. *Sylvania* rejected this equivalence and recognized that a restraint that a manufacturer, in its own interests, places on a group of dealers is much less likely to cause consumer harm than a restraint that dealers have agreed on among themselves, in their own interests. *See* 433 U.S. at 58-59 & n.28. And both defenders and critics of *Dr. Miles* agree that the most troublesome vertical price arrangements are those in which a manufacturer has been induced, or coerced, into support of a dealer cartel. *Compare* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo.

L.J. 1487, 1490-1491 (1983) (explaining that "a horizontal dealer cartel with manufacturer-supplier participation is likely to produce a more stable and durable dealer cartel than a purely horizontal arrangement"), *with* Bork, *supra*, at 292 ("The dealer cartel objection arises from the observation that some seemingly vertical restraints may actually have been forced upon manufacturers by a reseller cartel."); *see also Sharp Elecs.*, 485 U.S. at 725-726 ("[V]ertical price agreements * * * might be used to organize cartels at the retailer level"); *Center Video Indus. Co.*, 995 F.2d at 737 (explaining "theory" that "prohibiting resale price maintenance agreements denies to potential retail-level cartels the only effective enforcement mechanism available to them").

Under existing precedent, however, evidence that a restraint is imposed by a manufacturer contrary to dealer preferences may convert otherwise legal agency arrangements into an illegal price conspiracy. *See Simpson* v. *Union Oil Co.*, 377 U.S. 13 (1964). This not only means that evidence of fundamental *disagreement* may be used to support a *conspiracy* claim—the problem noted above, *see supra* at 8—but also that it cuts in precisely the wrong direction. *Dr. Miles* and its progeny have turned the law upside down.

III. THE DEMISE OF *DR. MILES* WILL NOT IMMUNIZE RESALE PRICE MAINTENANCE AGREEMENTS, BUT WILL SIMPLY PERMIT COURTS TO FOCUS ON ECONOMIC EFFECTS.

In light of the well-recognized economic benefits that may flow to consumers from manufacturer-driven vertical restrictions—price and non-price—the possibility that *some* vertical minimum resale price arrangements may cause anticompetitive harms does not justify *Dr. Miles*' *per se* prohibition. *Sylvania* explicitly rejected just this sort of logic. While the Court there declined to "foreclose the possibility that particular applications of vertical restrictions might justify *per se* prohibition," it emphasized that the default rule

for evaluating alleged antitrust violations is the rule of reason and that any departure from that rule must "be based on demonstrable economic effect." 433 U.S. at 58-59.

Rule-of-reason review is not a free pass for antitrust defendants. At one time, to be sure, this mode of analysis was vague and generalized, *see, e.g., Board of Trade* v. *United States*, 246 U.S. 231, 238 (1918), and operated in practical effect to legitimize the competitive practice under review. *See* Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 Geo. L.J. 305 (1987). That is no longer the case.

The judiciary's growing facility with economic principles and its experience in applying the rule of reason have lent real rigor to the inquiry. *See, e.g., FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447 (1986) (declaring horizontal non-price agreement among competitors unlawful under rule of reason); *NCAA* v. *Board of Regents*, 468 U.S. 85 (1984) (declaring agreement among competing colleges and universities to limit number of televised college football games unlawful under rule of reason). Indeed, this Court and the lower courts have adopted structured, or "quick look," applications of the rule of reason, *see, e.g., NCAA*, 468 U.S. at 109-111 & n.39; *National Soc'y of Prof'l Eng'rs* v. *United States*, 435 U.S. 679, 692 (1978); *Chicago Prof'l Sports Ltd. P'ship* v. *National Basketball Ass'n*, 961 F.2d 667, 674 (7th Cir. 1992), which include "screening" devices like market power tests, to retain the benefits of the sophisticated rule-of-reason analysis while reducing its associated burdens, *see, e.g., Rothery Storage & Van Co.* v. *Atlas Van Lines*, 792 F.2d 210, 221 (D.C. Cir. 1986); *Graphic Prods. Distribs., Inc.* v. *Itek Corp.*, 717 F.2d 1560, 1568-1569 (11th Cir. 1983). The guidelines adopted by the government agencies charged with enforcing the antitrust laws have further enhanced the analytical rigor of the rule of reason. *See, e.g., Department of Justice & Federal Trade Commission Antitrust Guidelines for Collaborations Among Competitors*, available at http://www.ftc.gov/bc/bcburguidelines.htm (2000).

The *Sylvania* opinion took great care to explain that the purpose of the rule-of-reason analysis is to separate competitively beneficial (or neutral) practices from those that harm consumers. As the Court explained there, "[w]hen anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under [section] 1 of the [Sherman] Act." *Id.* at 59. There is no logical reason to treat vertical price restraints differently.

CONCLUSION

For the foregoing reasons, as well as those presented in the petition, the petition should be granted.

Respectfully submitted,

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NOVEMBER 2006

MOTION FILED

NOV 6 - 2006

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . .
Kay's Shoes,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

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On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Pursuant to Supreme Court Rule 37.2, the National Association of Manufacturers (NAM) moves for leave to file the attached brief *amicus curiae* in support of the petition. The Petitioner has consented to the filing of this brief. The Respondent has not, necessitating this motion.

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media, and the general public about the vital role that manufacturing plays in America's economic future and living standards.

The NAM's members face competition from domestic and foreign rivals, and thus have an abiding interest in the standards used to judge the legality of competitive practices. Indeed, because many of the NAM's members introduce their products into the marketplace through independent dealers, the NAM has a great concern about *per se* antitrust rules that stifle service and promotional programs that ultimately benefit consumers.

The NAM accordingly submits this brief in support of the petition because it presents a rare opportunity for this Court to reevaluate the utility of the *per se* rule against minimum resale price maintenance announced in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911). In the 95 years since that case was decided, subsequent courts, including this one, have sought to soften its blow by elevating formal distinctions above antitrust substance—an awkward and illogical end-run around the *Dr. Miles* rule. In particular, because *Dr. Miles* precludes courts from evaluating the competitive effects of a vertical price restraint, courts instead have focused their attention on whether any agreement to fix prices exists, rather than on evidence of consumer harm caused by a given vertical price restraint. The unsurprising byproduct of an analytical inquiry focused exclusively on the agreement or conspiracy element required for a Sherman Act Section 1 claim is an incoherent body of vertical restraints law that produces different results in cases with identical potential impact on consumers. This incoherence in turn forces manufacturers like the members of the NAM to walk a precarious line in their relationship with the dealers that distribute their products, with aggressive pro-competitive strategies that serve consumer welfare on one side—and treble damages on the other.

With its brief, the NAM seeks to contribute to the Court's understanding of the harmful distortions *Dr. Miles* has worked in the law of vertical restraints and the profound consequences those distortions continue to create for manufacturers in a fiercely competitive marketplace. Accordingly, the NAM respectfully requests that the Court

grant its motion for leave to file the attached brief *amicus curiae* in support of the petition.

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Respondent.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF AMICUS CURIAE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

STATEMENT OF INTEREST OF AMICUS CURIAE

The NAM is the nation's largest industrial trade association, representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media, and the general public about the vital role of manufacturing in America's economic future and living standards.

The NAM has participated in a number of cases before this Court, including cases involving antitrust issues. *See Weyerhaeuser Co.* v. *Ross-Simmons Hardwood Lumber Co., Inc.*, No. 05-381 (2006); *Volvo Trucks North Am., Inc.* v. *Reeder-Simco GMC, Inc.*, 546 U.S. 164 (2006); *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997); *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717 (1988); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984). And the NAM has a great interest in the question presented by the petition—whether vertical minimum resale price maintenance agreements should constitute *per se* antitrust violations, or whether they instead should be reviewed under the rule of reason—because the answer to that question has enormous practical importance for its members around the country.

The members of the NAM include numerous manufacturers that rely on independent dealers for distribution of their products to consumers. As a consequence of the inflexible *Dr. Miles* rule prohibiting manufacturers from agreeing on resale prices with the dealers who deliver their products to the consumer marketplace, this Court and lower courts have focused their attention on whether a manufacturer and its dealers have agreed to fix prices, rather than on whether a given vertical price restraint enhances or harms consumer welfare. The formalistic distinctions resulting from this myopic focus have unfortunately produced an inconsistent and arbitrary body of vertical restraints precedent that does not even facially implement the purposes of the antitrust laws. This state of affairs compels the NAM's members to focus on technical distinctions rather than economic realities as they attempt to reach arrangements with their dealers that will permit them to compete effectively in the marketplace but will not at the same time constitute an antitrust violation with a concomitant treble damages sanction.

The NAM thus offers this brief because of the critical stake its members have in ensuring that they can legally enter into

arrangements with dealers to enhance inter-brand competition and ultimately to benefit consumers.[1]

SUMMARY OF ARGUMENT

Nearly a century ago, in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court announced a *per se* rule against vertical price restraints. Since then, *Dr. Miles* has proven to be "one decisive misstep that has controlled a whole body of law." Robert H. Bork, *The Antitrust Paradox: A Policy at War with Itself* 32 (Free Press 1993). With that case, "the law of resale price maintenance * * * has been rendered mischievous and arbitrary to this day by the premise laid down there." *Id.*

Dr. Miles has wreaked havoc not just in the law of resale price maintenance. Almost immediately after it was announced, this Court and the lower courts began to seek ways to cabin its reach. But they have done so only by tinkering with another area of antitrust law—namely, the standard for determining whether an "agreement" to restrain trade exists under Section 1 of the Sherman Act. *See* 15 U.S.C. § 1. Because the *per se* rule of *Dr. Miles* forecloses all inquiry into the competitive effects of resale price maintenance, courts have focused their attention on evidence of "agreement," rather than on the harm—or benefit—to consumers from a given practice. But as this Court has explained, "the primary purpose of antitrust laws is to protect interbrand competition," *State Oil Co.* v. *Kahn*, 522 U.S. 3, 15 (1997) (citing *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988)), not to regulate manufacturer-dealer relationships.

The consequence of this persistent distraction from the proper aim of antitrust has been the emergence of a body of

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[1] No counsel for any party authored this brief in whole or in part, and no person or entity, other than amicus curiae and its members, made a monetary contribution to the preparation or submission of this brief. S. Ct. Rule 37.6.

law that is contradicted by the plain economic realities of modern commercial life and that has necessarily produced divergent results in cases involving identical competitive harms. The distortions caused by *Dr. Miles* also have thrust the law of vertical price restraints into irreconcilable tension with the Court's modern antitrust jurisprudence, which is firmly rooted in sophisticated economic analysis.

This petition affords the Court an opportunity to correct the misstep in *Dr. Miles*, and in the process dispel the resulting deep inconsistencies in its antitrust jurisprudence, bring its doctrine in line with sound economic and antitrust policy, and refocus lower courts on the proper aim of antitrust law—to protect consumers from anticompetitive practices. The Court should take this opportunity, grant the petition, and give *Dr. Miles* a proper and long overdue burial.

The end of *Dr. Miles*, to be clear, will not render all vertical price restraints *per se lawful*. Rather, it will only make resale price maintenance arrangements between manufacturers and dealers subject to the time-tested rule-of-reason analysis, which allows courts to carefully weigh the competitive benefits and harms of a given arrangement. This Court has explicitly held that this approach is the proper default standard for assessing alleged antitrust violations absent economic justification warranting some deviation from that rule.

ARGUMENT

I. THE PETITION PROVIDES THE COURT AN OPPORTUNITY TO ELIMINATE A STRIKING ANACHRONISM FROM ITS MODERN ANTITRUST JURISPRUDENCE.

The question presented in this case is whether this Court should reconsider the *per se* restriction on vertical minimum resale price maintenance that *Dr. Miles* announced nearly a century ago in reliance on a common law prohibition against "general restraint[s] upon alienation." 220 U.S. at 404; *see also United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365,

380 (1967). The answer to that question is yes. The rule announced in *Dr. Miles* is a relic of an era in antitrust law that has long outlived its usefulness.

In its seminal decision in *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36, 47 (1977), this Court announced that "[r]ealities must dominate the judgment" of alleged restraints of trade and that "[t]he Anti-Trust Act aims at substance." With those statements the Court began a steady march toward a rule-of-reason approach rooted in conventional economic analysis. As the Court explained in *Sylvania*, any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing." *Id.* at 58-59.

The Court indeed has not hesitated to overrule even relatively recent precedent in service of that directive, recognizing that in the area of antitrust it must "adapt[ ] to changed circumstance[s]," apply "the lessons of accumulated experience," and reconsider decisions when their "theoretical underpinnings * * * are called into serious doubt." *State Oil*, 522 U.S. at 20-21. Thus, in *State Oil*, the Court held maximum resale price restraints subject to the rule of reason, despite having held them *per se* invalid barely a quarter of a century earlier in *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1968). And in *Sylvania*, the Court held non-price vertical restraints subject to rule-of-reason analysis, even though it had subjected them to *per se* treatment only ten years earlier in *Schwinn*, 388 U.S. 365.

The *per se* rule recognized in *Dr. Miles* is of far earlier vintage than those abandoned precedents. Indeed, unlike *Albrecht* and *Schwinn*, the rule of *Dr. Miles* was adopted a month before this Court first recognized any form of the rule of reason, *see Standard Oil Co. of New Jersey* v. *United States*, 221 U.S. 1 (1911). As with *Albrecht* and *Schwinn*, *Dr. Miles*'s day has come.

The "great weight of scholarly opinion" has condemned *Dr. Miles*' *per se* prohibition on vertical minimum resale price maintenance arrangements. *Sylvania*, 433 U.S. at 47-48. The petition amply demonstrates the harsh treatment the rule

has received over the years at the hands of judges, economists and legal scholars. *See* Pet. 11-16. These criticisms are sound, and there is no need to recapitulate them here.

The NAM instead devotes the bulk of the following pages to a discussion of the continuing anachronisms in the law of conspiracy that have resulted from courts' efforts to apply—or indeed avoid applying—*Dr. Miles*'s outmoded *per se* ban on vertical minimum resale price maintenance arrangements in the modern commercial setting.

II. THE HARMFUL EFFECTS OF *DR. MILES* ARE NOT CONFINED TO THE RESALE PRICE MAINTENANCE CONTEXT.

Because it rendered all vertical price restraints *per se* unlawful, *Dr. Miles* has played havoc in the law of vertical restraints by affirmatively preventing courts from analyzing whether such vertical price restraints are consistent with the purpose of antitrust law to facilitate inter-brand competition. Instead of examining whether a vertical minimum resale price maintenance arrangement actually harms consumers, *Dr. Miles* restricts courts to a highly formalistic inquiry into whether a given manufacturer-dealer arrangement constitutes an agreement on prices. Because the approach required by *Dr. Miles* is at odds with economic principles this Court has embraced in other contexts, it has also necessarily placed the vertical price restraints doctrine in deep tension with other areas of this Court's antitrust jurisprudence. Specifically, *Dr. Miles* has worked significant mischief in courts' more general efforts to determine whether an agreement exists at all under Section 1 of the Sherman Act.

A. *Dr. Miles* Has Distorted The Standards For Determining The Existence Of A Conspiracy.

The Court's efforts to limit *Dr. Miles*'s reach commenced not long after *Dr. Miles* issued. In *United States* v. *Colgate & Co.*, 250 U.S. 300 (1919), the Court carved out an exception to *Dr. Miles* by affirming a manufacturer's right to announce a unilateral resale pricing policy and to enforce that

policy by refusing to do business with a dealer that will not follow it. While the Court sensibly vindicated a manufacturer's basic right to choose its dealers, *Colgate* necessarily distorted ordinary principles of contract law, under which an agreement may be formed by an offer and subsequent performance—not explicit acceptance.

Legal scholars and courts alike have recognized the deformation of contract principles that *Colgate* produced as a byproduct of its attempt to blunt the force of *Dr. Miles*. Judge Posner has explained, for example, that "if a manufacturer distributes a price list, together with an announcement that he will cut off dealers who sell below the list price, and dealers adhere to those prices because they don't want to be cut off, there is a realistic sense in which the threat of termination has induced the dealer to agree not to cut prices—to agree, in other words, to fix prices." *Isaksen* v. *Vermont Castings, Inc.*, 825 F.2d 1158, 1164 (7th Cir. 1987).

Scholars with varied perspectives similarly have stressed that the clinical approach to the agreement prong of a Sherman Act Section 1 claim required by *Colgate* necessarily produces inconsistent results. This is because *Colgate* effectively requires courts to forgo an assessment of the harm, if any, caused by an alleged vertical agreement in restraint of trade, in favor of an inquiry into whether there is sufficient evidence that an agreement exists in the first place. Thus, as two noted commentators have explained, "[i]f * * * the *Colgate* case is aggressively applied, courts will reach inconsistent results in cases with identical competitive injuries" because "[a] premium would be placed upon a plaintiff's ability to make an evidentiary showing that does not further analysis of the injury caused by the restraint." Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* 325 (2000). The same commentators concluded that "[a] sound policy approach to distribution restraints emphasizes economic policy, not a sterile debate over whether a conspiracy or agreement exists." *Id.* But the law today instead requires a focus on the "agreement."

The Court's effort in *Colgate* to mitigate the error of *Dr. Miles* thus only compounded the problem. In *United States* v. *Parke, Davis, & Co.*, 362 U.S. 29, 47 (1960), the Court narrowed the rule it announced in *Colgate* by holding that the rule did not apply (and therefore that *Dr. Miles did* apply) if the manufacturer took "affirmative action to achieve uniform adherence" to its resale policy. Unlike dealers' "voluntary acquiescence" in a manufacturer's policy, the Court reasoned, affirmative action by a manufacturer interfered with a dealer's free choice and necessarily involved the assistance of other dealers in enforcing the policy—which constituted forbidden concerted action. *Id.* As a result of this distinction between voluntary acquiescence and coercion, evidence of *disagreement* between a manufacturer and dealer may thus actually signal an *agreement* to fix prices. *Cf. Isaksen*, 825 F.2d at 1163 ("[A]n agreement procured by threats is still an agreement for purposes of section 1.").

Since *Parke, Davis*, the Court has made it more difficult to prove *per se* illegal vertical agreements in some circumstances, *see Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717 (1988) (agreement between manufacturer and one dealer to terminate price-cutting dealer not *per se* unlawful under *Dr. Miles* unless manufacturer and remaining dealer agree on resale price or price level); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 768 (1984) (requiring "evidence that tends to exclude the possibility of independent action by the manufacturer and distributor" and "reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective"), but these decisions have failed to mitigate the rigid formalism inherent in the basic inquiry. And the primacy the *Dr. Miles* rule (operating in conjunction with the *Colgate* doctrine) places on evidence of an agreement continues to plague the lower courts today.[2] In their effort to

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[2] *See, e.g., Center Video Indus. Co.* v. *United Media, Inc.*, 995 F.2d 735, 736 (7th Cir. 1993) (no concerted activity where video editing equipment dealer complained to manufacturer about

steer between *Colgate* and *Dr. Miles*, lower courts are driven to apply strained interpretations of contract law, while failing to address economic realities.

For example, in *The Jeanery, Inc.* v. *James Jeans, Inc.*, 849 F.2d 1148 (9th Cir. 1988), the court concluded that there was insufficient evidence of a conspiracy for the plaintiff, a jeans retail outlet store, to submit its vertical price-fixing claim against the manufacturer to a jury. *Id.* at 1161. The court reached this result even though the manufacturer had made it abundantly clear to its dealers that it expected them to charge a "keystone" retail price for its jeans—*i.e.*, a two-fold

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discounting dealer, manufacturer requested discounting dealer to "raise the company's prices," manufacturer later terminated the discounting dealer and, on its termination, complaining dealer raised its prices "higher than the prices that it was charging while in competition" with discounter); *Parkway Gallery Furniture, Inc.* v. *Kittenger/Pennsylvania House Group*, 878 F.2d 801, 801-803 (4th Cir. 1989) (no concerted activity where furniture manufacturer adopted policy "prohibit[ing] its dealers from soliciting or selling its furniture by mail or by telephone to consumers residing outside specified areas of retail responsibility" in consultation with its dealers and in response to their complaints about discount dealers, manufacturer solicited dealer reactions to its policy, some dealers expressed agreement with policy and indicated they would abide by it, and one dealer notified manufacturer of "a violation [of the policy] and sought enforcement"); *see also Glacier Optical, Inc.* v. *Optique Du Monde*, 46 F.3d 1141 (9th Cir. 1995) (insufficient evidence of concerted action where dealers complained to supplier about discounters, supplier threatened to terminate discounters and monitored and investigated sales to discounters); *Holabird Sports Discounters* v. *Tennis Tutor, Inc.*, 993 F.2d 228 (4th Cir. 1993) (insufficient evidence of concerted action where manufacturer had policy against selling to dealers that advertised product for less than suggested retail price, monitored violations of the policy, and terminated non-complying dealer); *see generally* 1 *ABA Section of Antitrust Law, Antitrust Law Developments (Fifth)* 18-19 n.87 (ABA 2002).

markup of the wholesale price charged to the retailers—and that it would either terminate or deal less favorably with dealers that refused to charge the "keystone" price. *Id.* at 1150. This would obviously be considered concerted action in another context. But the Ninth Circuit rationalized that "this evidence [was] insufficiently probative of a conspiracy to permit the case to go to a jury," *id.* at 1157, because it did "not support a reasonable inference of concerted behavior," *id.* at 1161.

Similarly, in *Euromodas, Inc.* v. *Zantella*, 368 F.3d 11 (1st Cir. 2004), the First Circuit held that the plaintiff dealer—a retail men's clothing store—failed to adduce sufficient evidence "reflect[ing] a commitment on [the clothing manufacturer's] part to a minimum retail price maintenance scheme." *Id.* at 19. But there was evidence that when another retail men's store complained that the plaintiff was underselling it by sharply discounting the price of certain trousers, the manufacturer provided assurances that it would "take care of" the problem—and did so by terminating the relationship with the price-cutting dealer. *See id.* at 18-19. Rather than zeroing in on the question whether the termination of the price-cutting dealer was prompted by a breach of an actual agreement to fix the resale price of trousers, it would have been more consistent with the guiding purposes of antitrust law if the court had been permitted to consider whether the manufacturer's decision to retain one dealer and terminate another harmed or benefited consumers in the long run. Had the court been able to do so, its ultimate conclusion may well have been the same—but the decision would have been rooted in antitrust substance, rather than antitrust formalism. *Dr. Miles* precludes any such inquiry, however.

The formalistic approach spawned by *Dr. Miles* also undercuts the effectiveness of corporate compliance efforts. Counselors for manufacturers have to focus on whether communications with dealers contain language that could be construed as a verbal agreement, to the detriment of a proper focus on competitive effects.

The Court should take the opportunity presented by the petition to relieve lower courts and compliance counselors of the obligation to perform the sort of strained contract analysis evident in these cases—gymnastical inquiries that have created deep inconsistencies among decisions in this area of law.

B. The Distinctions Produced By *Dr. Miles* Are Directly Contrary To Economic Principles Endorsed By This Court.

The *Dr. Miles* rule has not only spawned a series of illogical and conflicting precedents; it is fundamentally inconsistent in multiple respects with the principles that animate *Sylvania*, in which this Court announced that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing." 433 U.S. at 58-59.

To begin with, following *Sylvania*, vertical *non*-price restraints are no longer *per se* unlawful, but are instead judged according to the rule of reason. While *Sylvania* preserved the *per se* rule for vertical minimum resale price restraints—finding that this form of trade restraint "involve[d] significantly different questions of analysis and policy"—there is no practical economic reason why vertical non-price restraints and vertical price restraints should be subject to disparate treatment. 433 U.S. at 51 n.18. Vertical restraints of any kind can be expected to affect price. Indeed, this Court itself noted in *Sharp* that "*all* vertical restraints * * * have the potential to allow dealers to increase 'prices' and can be characterized as intending to achieve just that." 485 U.S. at 728 (emphasis added). Yet such restraints "only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand competition to the point where the dealer's profit margin permits provision of the desired services." *Id.*

In fact, an outright agreement on resale price may not even have as great an effect on intra-brand competition as a non-price restriction. A vertical agreement on price eliminates only one form of intra-brand competition; an exclusive sales

territory or forward integration—non-price restrictions—prevent all forms of intra-brand competition. The result: strategies that *entirely prevent* intra-brand competition may be lawful, but strategies that only *limit* intra-brand price competition are never lawful. *Cf. id.* at 725 ("[T]he *per se* illegality of vertical restraints would create a perverse incentive for manufacturers to integrate vertically into distribution, an outcome hardly conducive to fostering the creation and maintenance of small businesses.").

This distinction has practical consequences in concrete cases—and courts have been forced to employ extreme intellectual ingenuity to avoid its implications. In *Eastern Scientific Co.* v. *Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir. 1978), for example, the First Circuit declined to place an acknowledged price restraint in the *Dr. Miles per se* category because it only applied to sales outside the dealer's assigned territory. The court of appeals rationalized that "[i]t may be true that defendant's policies here appear in form to *resemble resale price maintenance agreements*," but nonetheless concluded that "we are unable to conceive of how the resale price restrictions used to enforce the assigned territories in the present case can possibly have a greater anti-competitive effect than a pure policy of territorial restrictions." *Id.* at 885 (emphasis added).

Dr. Miles is also at odds with one of *Sylvania*'s fundamental insights. *Dr. Miles* was predicated, in part, on the premise that vertical price arrangements were tantamount to horizontal agreements among dealers. *See Dr. Miles*, 220 U.S. at 408. *Sylvania* rejected this equivalence and recognized that a restraint that a manufacturer, in its own interests, places on a group of dealers is much less likely to cause consumer harm than a restraint that dealers have agreed on among themselves, in their own interests. *See* 433 U.S. at 58-59 & n.28. And both defenders and critics of *Dr. Miles* agree that the most troublesome vertical price arrangements are those in which a manufacturer has been induced, or coerced, into support of a dealer cartel. *Compare* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo.

L.J. 1487, 1490-1491 (1983) (explaining that "a horizontal dealer cartel with manufacturer-supplier participation is likely to produce a more stable and durable dealer cartel than a purely horizontal arrangement"), *with* Bork, *supra*, at 292 ("The dealer cartel objection arises from the observation that some seemingly vertical restraints may actually have been forced upon manufacturers by a reseller cartel."); *see also Sharp Elecs.*, 485 U.S. at 725-726 ("[V]ertical price agreements * * * might be used to organize cartels at the retailer level"); *Center Video Indus. Co.*, 995 F.2d at 737 (explaining "theory" that "prohibiting resale price maintenance agreements denies to potential retail-level cartels the only effective enforcement mechanism available to them").

Under existing precedent, however, evidence that a restraint is imposed by a manufacturer contrary to dealer preferences may convert otherwise legal agency arrangements into an illegal price conspiracy. *See Simpson* v. *Union Oil Co.*, 377 U.S. 13 (1964). This not only means that evidence of fundamental *disagreement* may be used to support a *conspiracy* claim—the problem noted above, *see supra* at 8—but also that it cuts in precisely the wrong direction. *Dr. Miles* and its progeny have turned the law upside down.

III. THE DEMISE OF *DR. MILES* WILL NOT IMMUNIZE RESALE PRICE MAINTENANCE AGREEMENTS, BUT WILL SIMPLY PERMIT COURTS TO FOCUS ON ECONOMIC EFFECTS.

In light of the well-recognized economic benefits that may flow to consumers from manufacturer-driven vertical restrictions—price and non-price—the possibility that *some* vertical minimum resale price arrangements may cause anticompetitive harms does not justify *Dr. Miles*' *per se* prohibition. *Sylvania* explicitly rejected just this sort of logic. While the Court there declined to "foreclose the possibility that particular applications of vertical restrictions might justify *per se* prohibition," it emphasized that the default rule

for evaluating alleged antitrust violations is the rule of reason and that any departure from that rule must "be based on demonstrable economic effect." 433 U.S. at 58-59.

Rule-of-reason review is not a free pass for antitrust defendants. At one time, to be sure, this mode of analysis was vague and generalized, *see, e.g., Board of Trade* v. *United States*, 246 U.S. 231, 238 (1918), and operated in practical effect to legitimize the competitive practice under review. *See* Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 Geo. L.J. 305 (1987). That is no longer the case.

The judiciary's growing facility with economic principles and its experience in applying the rule of reason have lent real rigor to the inquiry. *See, e.g., FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447 (1986) (declaring horizontal non-price agreement among competitors unlawful under rule of reason); *NCAA* v. *Board of Regents*, 468 U.S. 85 (1984) (declaring agreement among competing colleges and universities to limit number of televised college football games unlawful under rule of reason). Indeed, this Court and the lower courts have adopted structured, or "quick look," applications of the rule of reason, *see, e.g., NCAA*, 468 U.S. at 109-111 & n.39; *National Soc'y of Prof'l Eng'rs* v. *United States*, 435 U.S. 679, 692 (1978); *Chicago Prof'l Sports Ltd. P'ship* v. *National Basketball Ass'n*, 961 F.2d 667, 674 (7th Cir. 1992), which include "screening" devices like market power tests, to retain the benefits of the sophisticated rule-of-reason analysis while reducing its associated burdens, *see, e.g., Rothery Storage & Van Co.* v. *Atlas Van Lines*, 792 F.2d 210, 221 (D.C. Cir. 1986); *Graphic Prods. Distribs., Inc.* v. *Itek Corp.*, 717 F.2d 1560, 1568-1569 (11th Cir. 1983). The guidelines adopted by the government agencies charged with enforcing the antitrust laws have further enhanced the analytical rigor of the rule of reason. *See, e.g., Department of Justice & Federal Trade Commission Antitrust Guidelines for Collaborations Among Competitors*, available at http://www.ftc.gov/bc/bcburguidelines.htm (2000).

The *Sylvania* opinion took great care to explain that the purpose of the rule-of-reason analysis is to separate competitively beneficial (or neutral) practices from those that harm consumers. As the Court explained there, "[w]hen anticompetitive effects are shown to result from particular vertical restrictions they can be adequately policed under the rule of reason, the standard traditionally applied for the majority of anticompetitive practices challenged under [section] 1 of the [Sherman] Act." *Id.* at 59. There is no logical reason to treat vertical price restraints differently.

CONCLUSION

For the foregoing reasons, as well as those presented in the petition, the petition should be granted.

Respectfully submitted,

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NOVEMBER 2006

2/22/07

(24)

No. 06-480

IN THE
Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . . Kay's Shoes,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

JOINT APPENDIX

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PETITION FOR WRIT OF CERTIORARI FILED OCTOBER 4, 2006
CERTIORARI GRANTED DECEMBER 7, 2006

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RELEVANT DOCKET ENTRIES IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

COURT OF APPEALS DOCKET #: 04-41243
PSKS Inc, et al v. Leegin Creative

* * *

9/25/04 Private civil diversity case docketed. NOA filed by Appellant Leegin Creative. [04-41243] (pac)

* * *

12/28/04 Appellant's Brief filed by Appellant Leegin Creative. Copies of Brief: 7 # of pages: 58 Word count: 13,694 Date of COS: 12/24/04 Hand Delivered [Y/N]: n Disk Provided [Y/N]: y Sufficient [Y/N]: n NEEDS APPEARANCE FORM FOR ATY BAKER. [5043066-1] [04-41243] A/Pet's Brief ddl satisfied. E/Res's Brief due 01/27/05 for Toni Cochran LLC, for PSKS Inc. Sufficient Brief due on 1/18/05 for Leegin Creative. (ddv)

* * *

2/25/05 Appellee's Brief filed by Appellee PSKS Inc, Appellee Toni Cochran LLC. Copies of Brief: 7 # of pages: 45 Word count: 10,902 Date of COS: 2/24/05 Hand Delivered [Y/N]: n Disk Provided [Y/N]: y Sufficient [Y/N]: y. [508442-1] [04-41243] E/Res's Brief ddl satisfied. Reply Brief due on 3/11/05 for Leegin Creative. (jca)

* * *

3/15/05	Reply brief filed by Appellant Leegin Creative. Copies of Brief: 7 # of pages: 30 Word count: 6,834 Date of COS 3/14/05 Disk Provided [Y/N]: y Sufficient [Y/N]: y. [5107009-1] [04-41243] Reply Brief ddl satisfied. (jca)
	* * *
12/7/05	Oral argument heard. Case argued by Tyler Alexander Baker for Appellant Leegin Creative, Jeffrey Scott Levinger for Appellant Leegin Creative, Robert W Coykendall for Appellee Toni Cochran LLC, Appellee PSKS Inc [04-41243] (sme)
	* * *
3/20/06	Opinion filed. Mandate pull date is 4/10/06. [04-41243] (rmf)
3/20/06	Judgment entered and filed. [04-41243] (rmf)
	* * *
4/3/06	Petition filed by Appellant Leegin Creative for rehearing. # of copies filed: 4 [5412300-1] Mandate pull date canceled. Date of COS: 4/3/06 Sufficient [Y/N]: Y [04-41243] (rjd)
4/3/06	Petition filed by Appellant Leegin Creative for rehearing en banc. # of copies filed: 20 [5412303-1] Date of COS: 4/3/06 Sufficient [Y/N]: Y [04-41243] (rjd)
	* * *
4/27/06	Response/opposition filed by Appellee PSKS Inc, Appellee Toni Cochran LLC to petition for rehearing [5412300-1] by Appellant Leegin Creative, petition for rehearing en banc [5412303-1] by Appellant Leegin Creative Response/Opposition ddl satisfied. Date of COS: 4/26/06 Sufficient [Y/N]: Y [5434432-1] [04-41243] (cpd)

7/19/06 COURT Order filed denying petition for rehearing [5412300-1], denying petition for rehearing en banc [5412303-1] With poll (Y/N)?: N Mandate pull date is 7/26/06. Copies to all counsel. [04-41243] (cpd)

7/25/06 Motion filed by Appellant Leegin Creative to stay the mandate [5509712-1] Response/Opposition due on 8/7/06. Date of COS: 7/24/06 Sufficient [Y/N]: y [04-41243] (sat)

* * *

7/31/06 Response/opposition filed by Appellee PSKS Inc to motion to stay mandate [5509712-1] by Appellant Leegin Creative Response/Opposition ddl satisfied. Date of COS: 7/28/06 Sufficient [Y/N]: y [5513423-1] [04-41243] (sat)

8/7/06 Reply filed by Appellant Leegin Creative to response/opposition [5513423-1], motion to stay mandate [5509712-1] Sufficient [Y/N]: Y [5518814-1] [04-41243] (cpd)

8/11/06 COURT Order filed denying motion to stay mandate [5509712-1] (RHB) Copies to all counsel. [04-41243] (sat)

8/15/06 Mandate issued. Approved BOC Issued (Y/N)?: n [04-41243] Mandate pull date satisfied. (sat)

* * *

8/22/06 Filing Sup Ct order entered 8/22/06 recalling this Court's mandate and staying this case pending receipt of a response and further order of the undersigned or of the Court. This order is conditioned upon the posting of a good and sufficient bond with the Clerk of the USCA, the adequacy of such bond to be determined by that Court. [04-41243] (ams)

8/23/06 COURT Order filed. This court's 15 August 2006 mandate was recalled and stayed on 22 August by the Supreme Court pending other proceedings. The order was "conditioned upon the posting of a good and sufficient bond with [our court], the adequacy of such bond to be determined by [our] Court". It is this court's understanding, however, that: an unopposed motion for a bond in the amount of $4.25 million was filed in the United States District Court for the Eastern District of Texas; and any bond should be posted there. Therefore, this matter is remanded to that court for the bond to be posted there, consistent with the condition imposed by Supreme Court's 22 August order. [5532619-1] Awaiting DC Action on 9/7/06. (RHB, EBC, KDE) Copies to all counsel. [04-41243] (ams)

8/28/06 SUPREME COURT Order filed. The application to recall and stay the mandate of the USCA for the 5th Circuit, presented to Justice Scalia and by him referred to the Court is granted pending the timely filing and disposition of a petition for a writ of certiorari. Should the petition for a writ of certiorari be denied, this stay shall terminate automatically. In the event the petition for a writ of certiorari is granted, the stay shall terminate upon the issuance of the judgment of this Court. This order is conditioned upon the remaining in effect of the bond posted in the USDC for the Eastern District of Texas. [04-41243] (ams)

* * *

RELEVANT DOCKET ENTRIES IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF TEXAS

CIVIL DOCKET FOR CASE #: 2:-03-cv-00107-TJW

* * *

Date Filed	#	Docket Text
04/25/2003	1	Original Complaint filed. Cause: 28:1337 Sherman-Clayton Act (poa) (Entered: 04/28/2003)
* * *		
06/05/2003	4	Answer & Counterclaims to complaint by Leegin Creative (ktd) (Entered: 06/12/2003)
06/05/2003	4	Counterclaim by Leegin Creative against PSKS Inc (ktd) (TWO-PLEADING DOCUMENT. SEE #4 Answer & Counterclaims to complaint) Modified on 11/15/2006 (ehs,) (Entered: 06/12/2003)
* * *		
07/03/2003	12	REPLY to counterclaim by PSKS Inc (poa) (Entered: 07/07/2003)
07/09/2003	13	Reply (Answer) to counterclaim by PSKS Inc (ktd) (Entered: 07/09/2003)
* * *		

09/17/2003	23	First Amended complaint by PSKS Inc, Toni Cochran LLC, (Answer due 9/29/03 for Leegin Creative) amending [1-1] complaint (exhibits not scanned) (ktd) (Entered: 09/17/2003)
* * *		
10/13/2003	26	Filed in Tyler Answer & Counterclaims to first amended complaint by Leegin Creative (ktd) Modified on 10/15/2003 (Entered: 10/15/2003)
10/13/2003	26	Filed in Tyler Amended counterclaim by Leegin Creative against Leegin Creative: amending [4-1] counter claim (ktd) (TWO-PLEADING DOCUMENT. SEE #26 Answer & counterclaims to first amended complaint by Leegin Creative) Modified on 11/15/2006 (ehs,). (Entered: 10/15/2003)
* * *		
11/04/2003	28	Answer to counterclaim of dft by PSKS Inc (ktd) (Entered: 11/04/2003)
* * *		
03/05/2004	42	MOTION to Limit the Testimony of Kenneth G Elzinga by PSKS Inc, Toni Cochran LLC. (exhibits not attached) (poa,) (Entered: 03/08/2004)
* * *		

03/18/2004	58	RESPONSE to Motion re 42 MOTION to Limit the Testimony of Kenneth G Elzinga filed by Leegin Creative Leather Products Inc. (ktd,) (Entered: 03/22/2004)
	* * *	
03/26/2004	62	MEMORANDUM OPINION & ORDER granting 42 Motion to limit the testimony of Kenneth G Elzinga for the reasons expressed in this order, and to the extent set forth herein. Signed by Judge T. John Ward on 3/25/04. (ktd,) (Entered: 03/26/2004)
03/26/2004	63	FILED UNDER SEAL Renewed MOTION for Summary Judgment by PSKS Inc, Toni Cochran LLC. (ktd,) Additional attachment(s) added on 11/15/2006 (ehs,). (Entered: 03/26/2004)
	* * *	
04/01/2004	67	RESPONSE to Motion re [63] Renewed MOTION for Summary Judgment, filed by Leegin Creative Leather Products Inc. (kjr,) (Entered: 04/02/2004)
	* * *	

04/02/2004	73	ORDER re [63] MOTION for Summary Judgment filed by PSKS Inc, Toni Cochran LLC. The ct will carry this motion with the case to trial. Signed by Judge T. John Ward on 4/2/04. (ktd,) (Entered: 04/02/2004)
* * *		
04/12/2004	83	MOTION for Judgment as a Matter of Law by Leegin Creative Leather Products Inc. (poa,) (Entered: 04/12/2004)
* * *		
04/12/2004	88	Proposed Jury Instructions by Leegin Creative Leather Products Inc.; Request Nos. 1-7; requested by defendant and refused by the Court. (shd,) (Entered: 04/13/2004)
* * *		
04/13/2004	98	JURY VERDICT for the plaintiff. (shd,) (Entered: 04/13/2004)
* * *		
05/24/2004	107	JUDGMENT in favor of dft against pla. Judgment for $3,975,000.00 inclusive of costs and fees is entered for the pla against dft. Signed by Judge T. John Ward on 5/19/04. (ktd,) (Entered: 05/24/2004)
06/08/2004	108	Filed in Tyler MOTION for New Trial by Leegin Creative Leather Products Inc. (ktd,) (Entered: 06/10/2004)

06/08/2004	109	Filed in Tyler RENEWED MOTION for Judgment as a Matter of Law by Leegin Creative Leather Products Inc. (ktd,) (Entered: 06/10/2004)
06/23/2004	110	RESPONSE to Motion re 108 MOTION for New Trial filed by PSKS Inc. (ktd,) (Entered: 06/23/2004)
06/23/2004	111	RESPONSE to Motion re 109 MOTION for Judgment as a Matter of Law filed by PSKS Inc. (ktd,) (Entered: 06/23/2004)
* * *		
06/30/2004	116	REPLY to Response to Motion in support re 108 MOTION for New Trial filed by Leegin Creative Leather Products Inc. (mpv,) (Entered: 07/08/2004)
06/30/2004	117	REPLY to Response to Motion in support re 109 RENEWED MOTION for Judgment as a Matter of Law filed by Leegin Creative Leather Products Inc. (mpv,) (Entered: 07/08/2004)
* * *		
08/17/2004	119	ORDER denying 108 Motion for New Trial, denying 109 Motion for Judgment as a Matter of Law. Signed by Judge T. John Ward on 8/17/04. (mpv,) (Entered: 08/17/2004)

09/08/2004	120	MOTION for Bond (*Unopposed, Supersedeas*) by Leegin Creative Leather Products Inc. (Attachments: #1 Exhibit Supersedeas bond #2 Text of Proposed Order) (Carroll, Otis) (Entered: 09/08/2004)
09/15/2004	121	NOTICE OF APPEAL as to 119 Order on Motion for New Trial, Order on Motion for Judgment as a Matter of Law, 107 Judgment by Leegin Creative Leather Products Inc. Filing fee $ 255, receipt number 103331. (copies to USCA & attorneys; Transcript order form mld to attorney) (ktd,) (Entered: 09/15/2004
* * *		

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF TEXAS
MARSHALL DIVISION

PSKS, Inc. d/b/a Kay's Kloset	§	
. . . Kay's Shoes;	§	
and Toni Cochran, L.L.C.,	§	
d/b/a/ Toni's	§	
Plaintiffs,	§	
v.	§	Civil Action No.
	§	02-03CV-107 TJW
Leegin Creative Leather	§	
Products, Inc.	§	
Defendant.	§	

First Amended Complaint

For their causes of action against defendant LEEGIN CREATIVE LEATHER PRODUCTS, INC., PSKS, INC. d/b/a KAY'S KLOSET . . . KAY'S SHOES, and Toni Cochran, L.L.C., d/b/a Toni's, Plaintiffs, states and alleges as follows:

I.
Parties

1. Plaintiff PSKS, Inc. d/b/a Kay's Kloset . . . Kay's Shoes ("Kay's Kloset") is a corporation duly organized and registered in accordance with Texas law.

2. Plaintiff Toni Cochran, L.L.C., d/b/a Toni's ("Toni's) is a Limited Liability Corporation, duly organized and registered in accordance with Texas Law.

3. Defendant Leegin Creative Leather Products, Inc. ("Leegin") is a California Corporation. Defendant may be served with process by serving its registered agent, Jerry Kohl at 14022 Nelson Ave., Industry, California 91746.

II.
Jurisdiction

4. This Court has jurisdiction in this case under 28 USC § 1331, 28 USC § 1337, and 28 U.S.C. § 1367. This Court also has jurisdiction in this case as it involves a federal question. More specifically the case involves the Sherman Anti-Trust and Clayton Acts.

5. The court has jurisdiction over the state law claims by virtue of supplemental jurisdiction pursuant to 28 U.S.C. § 1367.

III.
Venue

6. Venue of this case is appropriate in the Eastern District of Texas under 15 U.S.C. §15(a). More specifically, Defendant is doing business in the Eastern District and has agents in the Eastern District. Additionally, venue of this case is appropriate in the Eastern District of Texas under 28 USC § 1391(b) and (c). Leegin has sufficient contracts with this district to subject it to personal jurisdiction. In fact, numerous retail stores, including ladies' boutiques, sell Brighton products supplied by Defendant Leegin. Further, the Brighton Ladies Division Manager for Defendant Leegin is Laura Young, who resides in Tyler, Texas. She has regional and/or national responsibility for Defendant Leegin, was a significant party to transactions involving Defendant Leegin and the Plaintiff Kay's Kloset, and on information and belief, at all natural times acted in the course and scope of her employment.

IV.
Facts of the Case

7. Plaintiff PSKS, Inc. does business as Kay's Kloset . . . Kay's Shoes in Lewisville, Texas. Kay's Kloset is a retail store for fashions, shoes and accessories. For a number of years, it has been a retail store for a line of handbags,

belts, jewelry and accessories manufactured by Defendant Leegin. It was instrumental in introducing Leegin's Brighton line of products to the market Kay's Kloset serves. Over the course of the years, these products have accounted for a substantial portion of plaintiff's business, and in the last 36 months accounted for approximately $1,500,000 or more in retail sales.

8. Plaintiff Toni Cochran, L.L.C., does business as Toni's in Livingston, Texas. Toni's opened in April, 2000, and began offering Brighton products. Between April, 2000, and February, 2002, Brighton products accounted for approximately $180,000 in retail sales at her store.

9. In the early 1990's Leegin began to manufacture the Brighton brand of products, which it markets as its signature product. Leegin distributes the Brighton line through thousands of independent retailers, as well as through stores directly owned or controlled by Leegin or its owner.

10. Defendant Leegin has, at material times, had a retail pricing and promotional policy to suppress price competition among retailers of Brighton products. Leegin applied suggested retail prices ("SRP") to the Brighton line through a so-called "Retail Pricing and Promotion Policy." A copy of this policy is attached hereto as exhibit "A." This policy solicits agreement from retailers not to discount Brighton products, permitting discounts only when agreed to in writing by Jerry Kohl, the owner of Leegin, or Laura Young, Ladies Division Sales Manager. Defendant Leegin has orchestrated and allowed certain retail discounts to certain of its favored customers, some of whom competed with Kay's Kloset in the Lewisville, Texas area. In the last twelve months when Kay's Kloset learned of the discounting, and was losing Leegin-related business because of the discounting, Plaintiff began to compete by discounting Brighton products.

11. Beginning in the late Fall of 2002, and continuing thereafter, Leegin, began to enforce the SRP policy against

Kay's Kloset, attempting to secure agreement from Plaintiff to comply with the policy, while at the same time receiving agreements from other retailers to adhere strictly to Leegin's pricing policy. In conversations trying to secure plaintiff's agreement to adhere to the policy, Brighton's sales representative was asked whether a competitor of the plaintiff had agreed to the policy. Plaintiff was assured that the competitor had agreed to the policy, and that the competitor no longer would be discounting Brighton products.

12. Plaintiff Kay's Kloset had, at certain times, offered to its customers 20% off Leegin-related products to directly compete within Plaintiff's market. Leegin demanded that signs promoting the sale be removed, and threatened sanctions of loss of the Leegin product line. As stated by Leegin's sales representative, Jan Clinkscale, told the owners of Kay's Kloset: "When people discount, it always comes back to haunt them. We don't want people to discount—we want people to sell Brighton at regular price." When Plaintiff refused to adhere to the SRP, Leegin stopped shipping products to Kay's Kloset. At the time that Plaintiff was informed of the action taken by Leegin, Plaintiff was told that the action was subject to review if Plaintiff would indicate agreement to adhere to the SRP in the future.

13. Plaintiff Toni's, from time to time placed Brighton products on sale. On occasion when this would happen, Leegin' s sales representatives would call on her and attempt to secure her agreement not to place Brighton products on sale. When she refused to so agree in February 2002, Leegin stopped shipping to her.

14. Defendant has deliberately set up an unlawful retail pricing policy which it enforces to effect a vertical pricing control to monopolize the market and unfairly penalize the consumers of goods. Defendant reduces competition, which is and can be an effective tool to provide the consumer the maximum benefits of a free market. By enforcing independ-

ent retailers to agree not to discount, Defendant can insulate the retail stores it owns or controls from price competition.

15. As a result of the plaintiffs attempting to exercise their protected rights to compete, and to sell products at prices below those mandated by Leegin, Leegin deliberately sought to punish Plaintiffs, and cut off all future purchases of Leegin-related products. Plaintiff Kay's Kloset had, for many years, a growing business as a result of the sale of Leegin products. Plaintiff Kay's Kloset had an approximate forty-plus percent gross profit margin on the sale of those products, and will lose that base for sales and the anticipated profits of approximately $200,000 per year. Plaintiff Toni's will lose anticipated sales and approximately $50,000 in anticipated profits per year as a result of losing Brighton product sales. Plaintiffs estimate currently that it will take at least seven years for its lost market to be recovered, and that there is no particular line of products that will allow Plaintiffs to quickly find a replacement for the Brighton product line. Leegin-related products occupy such a position in the marketplace that they are not easily replaced, and it will take a long time for customer satisfaction and loyalty to be reestablished to a new product and in turn, Plaintiffs' stores. That is, not only do Plaintiffs lose the benefit of the particular attachment that customers have to Leegin products, it also loses those sales which were from other product lines purchased by Brighton customers. Plaintiffs' estimates of damage are preliminary and continuing.

V.
Causes of Action

16. Anti-Trust Violations: Defendant has committed anti-competitive acts in violations of the federal and state anti-trust laws. Defendant Leegin is a manufacturer and distributor of the Brighton line of clothing accessories. Plaintiffs were a retailers of Brighton products with Defendant. The

Brighton products affect interstate commerce in that the product line is sold and used throughout the country.

17. Defendant has engaged in a price fixing scheme for the Brighton line of products that is illegal per se, and fail as a permissible practice under what is known as the 'Colgate Doctrine'. Defendant has developed and enforced a pricing policy whereby retailers for Brighton products are required to observe "suggested retail prices". Defendant attempted to coerce Plaintiffs to enter into an illegal agreement to follow such suggested retail price. When Plaintiffs failed to do so, Defendant refused to provide any Brighton products for sale by Plaintiff. Defendant's actions in refusing to sell the Brighton line of products to Plaintiff have created an anti-competitive effect in the market for the Brighton line. Specifically, Defendant has violated the Sherman Anti-Trust Act and Clayton Act.

18. Defendant has also violated the anti-trust laws in that it has entered into agreements with retailers to charge only those prices fixed by Leegin. If a retailer refuses to enter into such an agreement, or if after agreeing to such a price fixing scheme, violates the agreement, Leegin deliberately withdraws their products from price competing retailers such as the Plaintiffs, at the request of and/or in combination with each other and competing retailers as part of a conspiracy to protect the other retailers from price competition and protect the suggested retail prices of Defendant.

19. Defendant has also violated Texas Business and Commerce Code § 15.05, et seq., relating to monopolies, trusts, and conspiracies in restraint of trade. Defendant has committed the unlawful practices as described above, including: a) entering into a contract, combination, or conspiracy in restraint of trade or commerce; b) monopolizing, attempting to monopolize, or conspiring to monopolize trade or commerce; and/or c) selling, leasing, or contracting for the sale or lease of goods for use, consumption, or resale, or to

fix a price for such use, consumption, or resale, or to discount from or rebate upon such price, on the condition, agreement, or understanding that the Plaintiff would not be permitted to sell Brighton products without conforming to a price fixing scheme, where the effect of the condition, agreement, or understanding may be to lessen competition substantially in trade or commerce.

20. As a consequence of Defendant's actions, Plaintiffs have suffered injury in the form of prospective lost profits, and are entitled to actual and treble damages. Defendant has taken actions to hurt the value and market share of Plaintiffs' retail business to the benefit of Defendant. As a result of Defendant's actions, Plaintiffs have suffered injury and are entitled to actual and treble damages in accordance with the federal and state anti-trust statutes.

21. Breach of Contract: Defendant sold goods to the Plaintiffs on the basis of FOB Defendant's factory in Industry City, California. Pursuant to the UCC, Plaintiffs were obligated to pay for actual shipping costs for the goods to be delivered to its store. Without informing the Plaintiffs, the defendant charged an amount well in excess of the actual charges for shipping, reimbursement for which costs it was entitled, breaching its obligation to the Plaintiffs. As a result the Plaintiffs were injured and now are entitled to recover the amount improperly charged.

22. Fraud: The Defendant billed the Plaintiffs for "shipping" charges. The bills took the form of Invoices generated by the Defendant and sent to the Plaintiffs. An example of such an invoice is attached hereto as Exhibit "B". Kay's Kloset received those invoices identified by invoice number in Exhibit "C" on or about the dates stated in that exhibit. Toni's received those invoices identified in Exhibit "D" on or about the dates stated in that exhibit. Each such invoice falsely stated that shipping charges were due in the amounts shown in Exhibits "C" and "D". The Plaintiffs relied upon

the representation of the Defendant that the shipping charges were proper charges, and the Defendant's implicit representation that the shipping charges represented the amount of the actual costs charged by the common carrier to deliver the goods. In reliance upon the shipping charge bills, the Plaintiffs paid those charges. The charges were false and inflated, and that the inflation of the charge was intentional by the Defendant. As a result of this false and fraudulent practice, the Plaintiffs are entitled to recover the difference between the actual freight costs, and the shipping charges made by the Defendant, as well as punitive damages.

23. Deceptive Trade Practices Act: The Plaintiffs were consumers of goods they purchased from the Defendant; the Defendant engaged in false, misleading and deceptive acts in charging more for shipping than the actual cost of shipping; and as a result of those charges, the Plaintiffs have been injured. Pursuant to the Texas Deceptive Trade Practices Act, the Plaintiffs are entitled to recover those damages suffered as well as attorney fees.

WHEREFORE, ON THE ABOVE PREMISES, Plaintiffs respectfully requests, after trial of this cause, that Plaintiff be awarded; a) actual damages; b) treble and/or punitive damages; c) attorney's fees and costs; and d) all other relief to which Plaintiffs may be justly entitled, including equitable relief necessary to protect Plaintiffs' interest and/or to reinforce the applicable protection of federal and state law.

Respectfully submitted,

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No. 06-480

FILED
JAN 22 2007
OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . .
Kay's Shoes,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

BRIEF FOR PETITIONER

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QUESTION PRESENTED

This Court has held that antitrust "*per se* rules are appropriate only for conduct that . . . would always or almost always tend to restrict competition." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988). Modern economic analysis establishes that vertical minimum resale price maintenance does not meet this condition because the practice often has substantial competition-enhancing effects. The question presented is whether vertical minimum resale price maintenance agreements should be deemed *per se* illegal under Section 1 of the Sherman Act, or whether they should instead be evaluated under the rule of reason.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

In addition to the parties named in the caption, Toni Cochran L.L.C., doing business as Toni's, was a plaintiff below. Its claims were dismissed by the district court before the case was submitted to the jury.

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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BRIEF FOR PETITIONER

OPINIONS BELOW

The court of appeals' opinion is unpublished but electronically reported at 2006 WL 690946. Pet. App. 1a. The order denying the petitions for rehearing and for rehearing en banc is unreported. *Id.* at 16a. The opinion of the United States District Court for the Eastern District of Texas is unreported. *Id.* at 12a.

JURISDICTION

The district court had jurisdiction over respondent's claims pursuant to 28 U.S.C. § 1331. The court of appeals had jurisdiction to review the district court's final judgment pursuant to 28 U.S.C. § 1291. The court of appeals filed its opinion on March 20, 2006. It denied the timely petitions for rehearing and for rehearing en banc on July 19, 2006. The petition for a writ of certiorari was filed on October 4, 2006, and granted on December 7, 2006. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 1 of the Sherman Act (15 U.S.C. § 1) provides, in pertinent part:

Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce . . . is hereby declared to be illegal.

STATEMENT

Petitioner Leegin Creative Leather Products, Inc. ("Leegin") respectfully requests that the Court overturn the *per se* rule of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), and reverse the decision below, which rests upon that legally and economically insupportable rule. Under the rule of *Dr. Miles*, agreements between a manufacturer and its retailers establishing minimum resale prices for the manufacturer's goods are *per se* unlawful. This *per se* rule is premised upon the antiquated common-law rule against "restraints on alienation," and it squarely conflicts with the modern economic understanding that resale price maintenance agreements can have significant *procompetitive* effects. This economic understanding has been embraced by this Court in a series of decisions over the last thirty years, in which the Court has overturned analogous *per se* rules against other vertical agreements that have similar competitive effects. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). As in *Khan* and *Sylvania*, the *per se* rule at issue here has been subject to overwhelming criticism and lacks support under the economic approach that this Court's recent antitrust jurisprudence has applied. By applying the rule of reason to resale price maintenance agreements, the Court can make the antitrust analysis of all vertical agreements consistent, economically rational, and proconsumer.

1. Leegin has built a successful family business in the crowded and intensely competitive marketplace for women's fashion accessories. In 1990, Leegin introduced the "Brighton" brand with a line of women's belts, and it later added other types of accessories to the Brighton line. Leegin has differentiated its products from the myriad other brands of leather goods and accessories available in department stores and mass merchandisers by focusing primarily on independently owned boutique stores offering a level of service and

personal attention that consumers frequently cannot find elsewhere. 6.R.5-11.[1]

Leegin's strategy has succeeded. Brighton has become a brand equated with quality, value, and customer service. Brighton products did not even exist until 1990, yet ten years later, despite competition from hundreds of other brands of women's accessories, Brighton products were sold in more than 5,000 specialty stores nationwide. 5.R.125-26; 6.R.17-20; 7.R.15. While Leegin has achieved impressive success from its humble beginnings, it is still a small company when compared to the much larger manufacturers and retailers with which it and its retailers compete. 3.R.813-20.

2. In 1997, as part of its overall strategy, Leegin instituted the "Brighton Retail Pricing and Promotion Policy," pursuant to which Leegin announced that it would do business exclusively with retailers who follow its suggested retail prices for Brighton products. 6.R.10.[2] There were two principal reasons for Leegin's adoption of the pricing policy. First, it was Leegin's view that the typical retail strategy of putting products on and off "sale" degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment. 5.R.106-24. Leegin's policy instead furthered an "everyday fair price" approach. *Id.* Second, the pricing policy was designed to develop the Brighton brand by giving retailers incentives to provide special attention and service to prospective Brighton customers. 5.R.115-27. In small specialty stores, attractive presentation and customer service are central to the shopping experience, but providing those services is not costless to retailers. *Id.* Through its pricing policy, Leegin ensured a sufficient margin to retailers

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[1] "R" refers to the record on appeal. Citations to the record are to the volume of the record, followed by the page number in that volume.

[2] Leegin's pricing policy permitted retailers to discount Brighton products that they did not wish to re-order from Leegin.

to give them the incentive to focus on Brighton products and to provide high-quality service. *Id.*

Leegin's pricing policy was successful, and sales of Brighton products grew considerably after its inception. For example, sales of Brighton handbags increased from 125,609 units in 1996, to 375,480 units in 2003. *See* Expert Report of Kenneth G. Elzinga ("Elzinga Report") at 20 n.26 (Pet. App. 37a).

3. Plaintiff PSKS, which operated a retail store known as "Kay's Kloset" in Lewisville, Texas, was one of the stores to which Leegin sold Brighton products. In December 2002, Leegin learned that PSKS was selling all Brighton products below the suggested prices, in violation of Leegin's pricing policy. 6.R.112-13. In response, Leegin suspended all shipments of Brighton products to PSKS. 6.R.118-19; 7.R.102-09. PSKS then filed this suit, alleging that Leegin's pricing policy constituted an unlawful agreement in restraint of trade under Section 1 of the Sherman Act.

At trial, the district court, applying the *per se* rule of *Dr. Miles*, refused to allow Leegin to introduce evidence that its pricing policy promoted interbrand competition. In particular, the court excluded the testimony of Leegin's economic expert, Professor Kenneth G. Elzinga. 1.R.325-33. Professor Elzinga would have testified, *inter alia*, that Leegin lacks market power and that its pricing practices were procompetitive because they fostered interbrand competition. Elzinga Report at 5-20 (Pet. App. 22a-37a). The district court also denied Leegin's request for an instruction that would have allowed the jury to apply the rule of reason (1.R.190-92), which requires an antitrust plaintiff to demonstrate that the defendant's conduct unreasonably restrains competition in a relevant market before it will be found unlawful (*see Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006)), and instead instructed the jury that the alleged resale price maintenance agreement between Leegin and its retailers was *per se* unlawful (11.R.42).

PSKS argued at trial that, because Leegin had referred to its pricing policy in written agreements with certain retailers, its otherwise lawful *policy* had been converted into an illegal *agreement*. The jury found that Leegin had agreed with its retailers to establish minimum resale prices, and therefore returned a verdict in favor of PSKS. Based on the verdict, the court awarded PSKS $3.6 million in trebled damages and $375,000 in attorneys' fees. Pet. App. 3a. Leegin renewed its motion for judgment as a matter of law and moved in the alternative for a new trial. The court denied Leegin's motions, stating that "[w]hether the per se classification of such agreements is wise is not for this court to decide." *Id.* at 12a.

The Fifth Circuit affirmed the district court's decision, rejecting Leegin's request for rule-of-reason treatment because lower courts "remain bound by [the Supreme Court's] holding in *Dr. Miles*." Pet. App. 4a.

After the Fifth Circuit refused to stay its mandate, Leegin applied to Justice Scalia for a stay pending the filing and disposition of a petition for a writ of certiorari. No. 06A179. Justice Scalia granted a temporary stay pending a response from PSKS. After a response was received, Justice Scalia referred the application to the Court, which granted the stay pending the filing and disposition of Leegin's petition.

This Court subsequently granted certiorari.

SUMMARY OF ARGUMENT

The *per se* rule against resale price maintenance established in *Dr. Miles* squarely conflicts with this Court's modern antitrust jurisprudence, which limits the use of *per se* rules to practices that "always or almost always tend to restrict competition and decrease output." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (internal quotation marks omitted). Like all other vertical agreements, the validity of resale price maintenance agreements should be determined on a case-by-case basis under the rule of reason—rather than under a rigid *per se* rule—because eco-

nomic analysis demonstrates that such agreements often have substantial *procompetitive* effects.

1. This Court has rejected *per se* treatment of vertical agreements that do not invariably have anticompetitive effects. *See State Oil Co. v. Khan*, 522 U.S. 3, 18 (1997) (unanimously overturning the *per se* rule against vertical maximum price-fixing because there was "insufficient economic justification" for the rule); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 47-48 (1977) (rejecting the *per se* rule against vertical nonprice restraints). In so doing, the Court has emphasized that a "departure from the rule-of-reason standard must be based upon demonstrable economic effect," *Sylvania*, 433 U.S. at 58-59, and it has required "experience with a particular kind of restraint [that] enables the Court to predict with confidence that the rule of reason will condemn it," *Khan*, 522 U.S. at 10 (internal quotation marks omitted). Neither of these prerequisites to *per se* treatment is met here.

The decision in *Dr. Miles* rests upon the outdated common-law prohibition upon "restraints on alienation"—a concept that the Court rejected in *Sylvania* and *Khan* as a basis for a *per se* rule—rather than upon economic analysis of resale price maintenance or judicial experience applying the rule of reason to such agreements. When modern economic analysis is brought to bear on resale price maintenance, it becomes clear that *per se* treatment is inappropriate because such agreements have a number of procompetitive uses that can enhance consumer welfare. *See, e.g.*, Thomas R. Overstreet, Jr., Bureau of Econ., Fed. Trade Comm'n, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 164 (1983) ("the economic theories and the available empirical evidence rather clearly suggest that the *rigid* application of a strict standard of per se illegality for RPM [resale price maintenance] is inappropriate" (emphasis in original)). For example, a manufacturer could use resale price maintenance to provide incentives for retailers to engage in promo-

tional activities that are necessary to the efficient marketing of its products, or a new entrant could use resale price maintenance to induce competent and aggressive retailers to carry its product and invest in demand-creating services. The provision of these sought-after services enhances interbrand competition and benefits consumers.

Although resale price maintenance may not *always* be used for such procompetitive purposes, there is no basis to conclude that the effects of resale price maintenance are so invariably harmful to competition as to justify *per se* treatment. In situations where the practice does have a substantial adverse effect on competition in a relevant market, rule-of-reason analysis is sufficient to proscribe its use.

2. Moreover, retaining the overbroad *per se* rule of *Dr. Miles* actually would reduce competition because the rule unnecessarily limits the options available for manufacturers to promote their products, reducing the variety of promotional strategies in the marketplace and forcing inefficient choices on manufacturers who would otherwise use resale price maintenance as a promotional tool. In this case, for example, Leegin used resale price maintenance to provide incentives for retailers to market its products effectively against its larger rivals, and the strategy allowed a small manufacturer to distinguish itself from its larger competitors and expand its marketplace presence. The antitrust laws should promote such efforts, not condemn them.

3. The reasons advanced by PSKS for retaining the rule of *Dr. Miles* do not justify its continued existence. For example, *stare decisis* is not a basis for retaining the rule of *Dr. Miles*. *Stare decisis* has diminished force in the antitrust context because the Sherman Act is a dynamic statute that Congress intended to be interpreted—and reinterpreted—in light of "changed circumstances and the lessons of accumulated experience." *Khan*, 522 U.S. at 20. Congress has never mandated application of a *per se* prohibition on resale price maintenance and has done nothing to modify this Court's

common-law-making function in this area. Accordingly, neither the force of precedent nor congressional action precludes this Court from reconsidering the *per se* rule against resale price maintenance in light of modern economic analysis that was not available to the *Dr. Miles* Court.

4. In addition, contrary to PSKS's argument, the *per se* rule of *Dr. Miles* cannot be justified on the theory that *per se* rules are more "efficient." On that theory, *per se* rules would be the norm rather than the exception in antitrust law. While it may be "efficient" to ignore an analysis of competitive effects when they are not easily ascertained, this Court has never adopted that approach. In any event, replacing the rule of *Dr. Miles* with rule-of-reason treatment might actually reduce the burden on the courts by discouraging the filing of economically groundless antitrust suits challenging procompetitive uses of resale price maintenance and by permitting earlier disposition of economically unsound claims that might otherwise go to a jury on the question of the existence of an agreement. Following *Sylvania*, the lower courts have developed substantial experience applying the rule of reason to vertical nonprice agreements, and the courts could draw upon the principles developed in that analogous context in assessing the competitive effects of resale price maintenance agreements.

5. In the absence of a rigid *per se* rule, the decision below cannot stand. The district court prevented Leegin from introducing any evidence regarding the procompetitive effects of its pricing policy and, relying on *Dr. Miles*, instructed the jury that resale price maintenance agreements are *per se* unlawful.

The decision below should be reversed.

ARGUMENT

I. THE RULE OF *DR. MILES* IS INCONSISTENT WITH THIS COURT'S MODERN ANTITRUST JURISPRUDENCE.

The *per se* rule against resale price maintenance is the lone remaining vestige of an antiquated antitrust regime that cannot be reconciled with either recent antitrust decisions or economic theory. This Court has abandoned the *per se* rules against other vertical arrangements—including vertical maximum price-fixing arrangements and all types of vertical nonprice agreements. Each of those other *per se* rules—like the rule of *Dr. Miles*—was based on the "ancient rule against restraints on alienation" (*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 380 (1967)), which has no grounding in economics. And each of the other vertical *per se* rules was rejected when the Court applied an approach to antitrust analysis grounded in real-world economics. This Court should likewise overturn the rule of *Dr. Miles*, and resolve a fundamental inconsistency between that outdated and overbroad *per se* rule and the Court's antitrust decisions of the last thirty years.

A. This Court Has Overturned Analogous *Per Se* Rules Against Other Vertical Agreements.

1. Nearly a century ago, this Court in *Dr. Miles* invalidated an agreement that required a manufacturer's dealers to abide by a minimum resale price. Without considering the competitive effect of the practice, the Court held that such arrangements are invalid under the Sherman Act because the "right of alienation is one of the essential incidents of a right of general property" and "restraints upon alienation have been generally regarded as obnoxious to public policy." *Dr. Miles*, 220 U.S. at 404 (internal quotation marks omitted). Equating a resale price maintenance agreement with a prohibited horizontal cartel among dealers, the Court opined that the manufacturer "can fare no better with its plan of identical

contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions." *Id.* at 408. In his dissenting opinion, Justice Holmes rejected the majority's approach and argued that, in many circumstances, the public would "be served best by the company being allowed to carry out its plan" to establish minimum resale prices. *Id.* at 412 (Holmes, J., dissenting).[3]

Following *Dr. Miles*, the Court adopted *per se* rules against other types of vertical arrangements. In *Schwinn*, the Court held that vertical nonprice agreements, namely restrictions on the territories or customers that distributors may serve, are *per se* unlawful. 388 U.S. at 379-80. As in *Dr. Miles*, the Court based this *per se* rule on the "ancient rule against restraints on alienation," rather than on economic analysis. *Id.* at 380 The next year, the Court held that vertical maximum resale price agreements are *per se* unlawful, based on similar concerns for protecting dealer freedom. *See Albrecht v. Herald Co.*, 390 U.S. 145, 152 (1968).

When the Court had occasion to reexamine these *per se* rules in light of modern economic analysis, however, it determined that vertical agreements often have procompetitive effects and are therefore more appropriately evaluated on a case-by-case basis under the rule of reason.

Sylvania is the seminal decision in this area. In *Sylvania*, this Court overturned *Schwinn*'s *per se* rule against vertical nonprice agreements, and expressly rejected the notion that the common-law rule against restraints on alienation could justify a *per se* rule of antitrust liability. *Sylvania*, 433 U.S. at 53 n.21. The Court explained that "the state of the common law 400 or even 100 years ago is irrelevant to the

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[3] *See also id.* ("I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own, and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get.").

issue before us: the effect of the antitrust laws upon vertical distributional restraints in the American economy today." *Id.* (internal quotation marks omitted). Instead, "[*p*]*er se* rules of illegality are appropriate only when they relate to conduct that is manifestly anticompetitive." *Id.* at 49-50. The Court made clear that interbrand competition "is the primary concern of antitrust law," and it explained that interbrand competition "provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." *Id.* at 52 n.19. The Court further explained that *per se* analysis is ill-suited to vertical restrictions "because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *Id.* at 51-52. In light of the potential for procompetitive effects on interbrand competition, the Court concluded that the validity of vertical non-price agreements should be determined under the rule of reason. *Id.* at 59.

Similarly, in *Khan*, this Court unanimously overruled its holding in *Albrecht* that vertical maximum price agreements are *per se* unlawful. As in *Sylvania*, the Court explained that concerns with "dealer freedom" are not an appropriate basis for a *per se* rule of antitrust liability. *Khan*, 522 U.S. at 16-17. Instead, the Court held that *per se* treatment is only "appropriate once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Id.* at 10 (internal quotation marks and alteration omitted). Building on the critiques of *Albrecht* offered by lower courts and commentators, the Court concluded that the *per se* rule should be rejected because there is "insufficient economic justification for *per se*" treatment of vertical maximum price agreements. *Id.* at 18.

The Court has also relied on *Sylvania* to limit the reach of *Dr. Miles*. In *Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), a case that did not require the Court to address the continued validity of *Dr. Miles*

itself, the Court refused to apply the *per se* rule of *Dr. Miles* to an agreement between a manufacturer and a complaining retailer that required the manufacturer to terminate another retailer who was a "discounter," but that did not impose specific prices or price levels on the complaining retailer. *Id.* at 731. The Court recognized that, like the vertical nonprice agreements in *Sylvania*, this agreement was "price affecting"—rather than "price setting"—and thus did not warrant *per se* treatment, and explained that the "rules in this area should be formulated with a view toward protecting the doctrine of *GTE Sylvania*." *Id.* at 726.

2. The reasoning of this Court's decisions in *Sylvania*, *Sharp*, and *Khan* severely undermines the rule of *Dr. Miles*. The Court's focus, nearly a century ago, on "restraints on alienation" is no longer a valid basis for a *per se* rule of antitrust law. Instead, a *per se* rule is appropriate *only* for "conduct that would always or almost always tend to restrict competition and decrease output." *Sharp*, 485 U.S. at 723 (internal quotation marks omitted). This Court has established certain critical prerequisites for deciding whether the high standard for applying a *per se* rule is met. Most importantly, a "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *Sylvania*, 433 U.S. at 58-59; *see also Sharp*, 485 U.S. at 724. Similarly, *per se* treatment is appropriate only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (internal quotation marks omitted). The Court has thus "expressed reluctance to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious.'" *Id.* (quoting *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 458-59 (1986)). As discussed below, the *per se* rule of *Dr. Miles* does not satisfy these criteria.

B. There Are No Demonstrable Economic Effects That Support *Per Se* Treatment Of Resale Price Maintenance.

In both *Sylvania* and *Khan*, this Court examined the economic effects of the vertical agreements at issue, including by considering "scholarly and judicial authority supporting their economic utility." *Sylvania*, 433 U.S. at 57-58; *see also Khan*, 522 U.S. at 15-19. Based on that examination, the Court found "insufficient economic justification" for *per se* treatment of vertical nonprice and vertical maximum price agreements. *Khan*, 522 U.S. at 18; *see also Sylvania*, 433 U.S. at 57-58. An economic analysis of resale price maintenance yields the same conclusion.

Indeed, economic and legal scholars have reached an unusually strong consensus that resale price maintenance has a number of procompetitive uses and effects that, if permitted by the antitrust laws, could enhance consumer welfare. *See, e.g.*, ABA Antitrust Section, *Antitrust Law and Economics of Product Distribution* 76 (2006) (the "bulk of the economic literature on RPM . . . suggests that RPM is more likely to be used to enhance efficiency than for anticompetitive purposes").[4] The predominant view among antitrust economists

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[4] *See also, e.g.*, Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1611 (2d ed. 2004); Robert H. Bork, *The Antitrust Paradox* 289 (1978); Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance* 1-5 (forthcoming 2007), *at* http://www.virginia.edu/economics/papers/mills/RPM%20for%20ABA.pdf; Roger D. Blair, Jill Boylston Herndon & John E. Lopatka, *Resale Price Maintenance and the Private Antitrust Plaintiff*, 83 Wash. U. L.Q. 657, 659, 697-714 (2005); Richard A. Posner, *Antitrust Law* 172 (2d ed. 2001) [hereinafter Posner, *Antitrust Law*]; David A. Butz, *Vertical Price Controls with Uncertain Demand*, 40 J.L. & Econ. 433, 455-57 (1997); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 72 (1993); Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597, 617 (1993); Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as*

that the *per se* rule of *Dr. Miles* should be overturned is underscored by the *amicus curiae* brief submitted by 25 distinguished economists in support of Leegin's petition for a writ of certiorari, which urged the Court to hold that resale price maintenance should be evaluated under the rule of reason. *See* Cert.-Stage Br. of *Amici Curiae* Economists 1-4.[5] Similarly, the Section of Antitrust Law of the American Bar Association recently adopted a resolution, which was passed unanimously by the Section's Council, stating that the Section "believes that the time has come to extend the rule of reason approach . . . to minimum resale price maintenance" because "minimum resale price maintenance, like other vertical restraints, can stimulate interbrand competition and is not so inevitably pernicious as to warrant per se illegality."[6]

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Contract Enforcement Mechanisms, 31 J.L. & Econ. 265 (1988); William F. Baxter, *The Viability of Vertical Restraints Doctrine*, 75 Cal. L. Rev. 933, 947-49 (1987); Terry Calvani & Andrew G. Berg, *Resale Price Maintenance After* Monsanto*: A Policy Still at War with Itself*, 1984 Duke L.J. 1163, 1180-82, 1187; Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 146-48 (1984); Overstreet, *supra*, at 11.

[5] The *amici* economists included members of the faculties of some of the Nation's leading academic institutions, as well as nine economists who have served as either the Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency). *See* Cert.-Stage Br. of *Amici Curiae* Economists app. 1a-4a.

[6] *See* ABA Section of Antitrust Law Report to the ABA House of Delegates 2-3 (2006), *at* http://www.abanet.org/antitrust/at-comments/2006/reports/ANTITRUST-RPM-REPORT-12-06.pdf. The recommendation was passed by the Section's Council by a vote of 25-0, with two abstentions and four members not voting. The ABA House of Delegates has not had an opportunity to consider the Section's recommendation as of the time of this filing; accordingly, the recommendation does not constitute the official policy of the ABA.

1. Vertical Price And Nonprice Restraints Often Have Procompetitive Effects On Interbrand Competition.

A simplistic—and incorrect—criticism of vertical restrictions (including both price and nonprice restraints) is that they limit intrabrand price competition, raise retailers' margins, often raise retail prices, and are therefore harmful to consumers. That analysis is wrong as a matter of economics and inconsistent with this Court's analysis of vertical restraints.

In *Sylvania*, the Court recognized that interbrand competition is the "primary concern of antitrust law." 433 U.S. at 52 n.19. The Court also recognized that manufacturers often use vertical restraints to create incentives for their dealers to provide service and promote the manufacturer's product, which, in turn, fosters interbrand competition:

> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products. . . . Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers. For example, new manufacturers and manufacturers entering new markets can use the restrictions in order to induce competent and aggressive retailers to make the kind of investment of capital and labor that is often required in the distribution of products unknown to the consumer. Established manufacturers can use them to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products.

433 U.S. at 54-55 (citation and footnote omitted). As the Court noted, "these services might not be provided by retail-

ers in a purely competitive situation" because of "market imperfections such as the so-called 'free rider' effect." *Id.* at 55. The Court recognized that, where free-riding is allowed, dealers lose the incentive to make investments that are valuable to consumers and enhance the competitiveness of the manufacturer's product because the free rider siphons off so many sales that the other retailers are not able to recover their investments in promotional services.

In addition, the Court explained in *Sylvania* that a manufacturer has no interest in overcompensating its retailers by enabling fat retail margins—to the contrary, "a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenues." 433 U.S. at 56 n.24 (internal quotation marks omitted). Accordingly, "manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products." *Id.* at 56; *see also* Bork, *supra*, at 290 ("No manufacturer or supplier will ever use either resale price maintenance or reseller market division for the purpose of giving the resellers a greater-than-competitive return. . . . The manufacturer shares with the consumer the desire to have distribution done at the lowest possible cost consistent with effectiveness.").

Notably, manufacturers use many tools to enhance their interbrand competitive position that might increase nominal prices to consumers. Manufacturers may engage in national advertising or upgrade their product features, the costs of which get passed through to consumers in the form of increased prices—yet no one would argue that this conduct in a competitive marketplace is an anticompetitive activity. *See* Elzinga & Mills, *supra*, at 8-9; Easterbrook, *supra*, at 141.

The presence of *inter*brand competition ensures that manufacturers' actions to promote their products—including vertical distribution restraints—are geared toward efficiency and procompetitive results. *Sylvania*, 433 U.S. at 52 n.19, 56

n.24. If the manufacturer takes actions that boost prices without promotional benefits that consumers desire, it will lose sales to its interbrand competitors. *Id.*; Overstreet, *supra*, at 48. On the other hand, if the manufacturer's sales increase because consumers are getting more services that they value, then consumers benefit. Elzinga & Mills, *supra*, at 9.[7]

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[7] Moreover, it is not the case that resale price maintenance necessarily leads to higher nominal retail prices. *See, e.g.*, Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. Pol. Econ. 1074, 1094 (1986) (concluding that "RPM need not raise prices at retail" and that "[e]ven if prices rise because of RPM, we cannot conclude that the practice is undesirable, for the higher prices . . . reflect the manufacturer's desire to provide information or other services to consumers, thereby increasing the demand for the manufacturer's product"). Indeed, empirical analysis has shown that the practice can, in some situations, actually result in *lower* nominal retail prices, in addition to the proconsumer benefits of increased services stimulated by the practice. *See id.* at 1091-93; Overstreet, *supra*, at 138-40. For example, if resale price maintenance allows a manufacturer to compete more effectively and thereby expand its sales and output, the manufacturer may achieve efficiencies in manufacturing or distribution that could allow it to lower its unit costs and prices. *See* Overstreet, *supra*, at 47-48. In addition, where a manufacturer has assurance that retailers will use a guaranteed minimum margin to provide sales-related services or engage in promotional efforts, a manufacturer may lower its wholesale prices in order to subsidize the increased services borne by retailers. *See* Marvel & McCafferty, *supra*, at 1084. In particular, where it is more efficient for a manufacturer to incent its retailers to provide promotional services than to promote the product itself at the manufacturer level (*e.g.*, through national advertising), resale price maintenance could allow a manufacturer to reduce its own promotional expenditures and channel its efforts through retailers in the form of lower wholesale prices that subsidize the retailers' promotional efforts. *See, e.g.*, Baxter, *supra*, at 945; Elzinga & Mills, *supra*, at 13 (describing the example of Coors, which used resale price maintenance to induce retailers to promote its product, but was forced to abandon this strategy and turn to national media advertising following a government challenge to its resale price maintenance policy); *see also Sylvania*, 433 U.S. at 56 n.25 (recognizing that *per se* rules against vertical restrictions are not likely to eliminate promotional ser-

In *Sharp*, the Court emphasized the similar economic effects of vertical price and nonprice restraints. "[V]ertical nonprice restraints only accomplish the benefits" to interbrand competition identified in *Sylvania* "*because they reduce intrabrand price competition* to the point where the dealer's profit margin permits provision of the desired services." *Sharp*, 485 U.S. at 728 (emphasis added). Indeed, "there is a substantial body of economic analysis supporting the view that the distinction" between vertical price and nonprice restraints "is largely illusory." ABA Antitrust Section, *supra*, at 59; *see also Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) ("the economic effect" of "price and nonprice restrictions" is in many cases "similar or identical"). As Justice White explained in his concurrence in *Sylvania*, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). Accordingly, the procompetitive uses of vertical territorial restraints to reduce intrabrand price competition identified by this Court in *Sylvania* and *Sharp* as supporting rule-of-reason treatment are equally applicable to resale price maintenance. *Id.* at 69-70; Posner, *Antitrust Law*, *supra*, at 184 ("any argument for the legitimacy of exclusive territories applies equally to resale price maintenance").

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vices, but may simply result in "a shift to less efficient methods of obtaining the same promotional effects"). Through the more efficient or effective promotion of its products, the manufacturer becomes a more robust competitor, competition in the interbrand marketplace is enhanced, and any promotional efficiencies may be passed through to consumers in the form of lower retail prices, notwithstanding the guaranteed margin provided to retailers by the resale price maintenance policy.

It is thus untenable that resale price maintenance should continue to be treated under a different legal standard than vertical nonprice agreements. *See* Cert.-Stage Br. of *Amici Curiae* Economists 16-18. By overturning the rule of *Dr. Miles*, this Court can put an end to the inexplicably divergent treatment of these similar vertical arrangements.

2. There Are Many Uses Of Resale Price Maintenance That Can Enhance Interbrand Competition And Consumer Welfare.

It is well-accepted among legal and economic scholars that resale price maintenance, like the vertical nonprice restraints discussed in *Sylvania*, would frequently be used for procompetitive purposes, such as providing incentives to retailers to stock and promote the manufacturer's products. *See, e.g.*, Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 81 (1998) ("[P]rice floor restraints are used in most cases unilaterally by a manufacturer to change the mix of price and non-price competition among retailers of its product. Restrictions on distribution are a means of competing on product quality."). "[N]o single specific theory explains all instances of [resale price maintenance]"—instead, there are a number of different purposes for which a manufacturer might implement resale price maintenance that are likely to have procompetitive virtues and enhance consumer welfare. Winter, *supra*, at 70. The common thread among these uses is that the manufacturer provides its retailers with a guaranteed margin as a means to enhance the manufacturer's competitive position against interbrand rivals.

The most frequently cited rationale for resale price maintenance is that a manufacturer might impose a price floor to ensure that dealers provide demand-creating services. *See, e.g.*, Elzinga & Mills, *supra*, at 3; Overstreet, *supra*, at 49; Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 91 (1960). In the absence of re-

sale price restraints, free-rider problems may diminish retailers' incentives to provide these services, harming the manufacturer and dampening interbrand competition. *See*, *e.g.*, Posner, *Antitrust Law*, *supra*, at 173.

Even outside the classic free-rider situation, resale price maintenance may be used by a manufacturer to provide its retailers with incentives to compete on service or other promotional activities, where the retailer might otherwise have an inherent bias to rely too much on low prices (and not enough on service or promotional activities) to attract customers, which could reduce the manufacturer's overall interbrand competitive position. *See* Winter, *supra*, at 62-64. While a manufacturer might theoretically contract with its retailers to provide certain services, the transaction and monitoring costs associated with such a program can be prohibitive, and it can be more efficient for a manufacturer to encourage retailers to compete on service by limiting intrabrand price competition. *See id.*; Klein & Murphy, *supra*, at 295.

A manufacturer may also use resale price maintenance to encourage retailers to stock its products by guaranteeing a minimum resale margin. Overstreet, *supra*, at 47. The ability to obtain distribution through resale price maintenance can be particularly important for a new or small manufacturer trying to break into the marketplace. *See*, *e.g.*, Mathewson & Winter, *supra*, at 60 ("In markets where extensive distribution systems are necessary, RPM is often used in the early part of a product's life cycle to aid in the establishment of the distribution system. In this situation, . . . RPM lowers the barriers of entry into upstream markets.").

Similarly, a manufacturer may use resale price maintenance to encourage its retailers to purchase more of its products, particularly in industries in which excess inventory can be subject to heavy discounting. Resale price maintenance ensures that retailers will be protected from a dramatic devaluation of their inventory when demand is unexpectedly low and, consequently, it reduces the chance that risk-averse

retailers will purchase too little out of concern for having unsold stockpiles at the end of the season. *See, e.g.*, Butz, *supra*, at 451-52. A manufacturer, in turn, might use resale price maintenance to expand output or introduce more innovative products because retailers would be more willing to carry its products, enhancing interbrand competition and benefiting consumers. *Id.* at 457.

3. The Possibility That Resale Price Maintenance Might Be Used By A Cartel Does Not Justify The Rule Of *Dr. Miles*.

Of course, not every use of resale price maintenance is necessarily procompetitive. It is possible, for example, that resale price maintenance (just like vertical territorial restraints) might be used to enforce a horizontal agreement among dealers or manufacturers. Posner, *Antitrust Law*, *supra*, at 183-85. The conditions in which such a cartel might theoretically operate, however, are not common. Elzinga & Mills, *supra*, at 5-6; Easterbrook, *supra*, at 141-43. And, as demonstrated by empirical studies, instances of resale price maintenance being used for procompetitive purposes are "far more common" than instances in which it is used to facilitate a cartel. Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 282 (1991); *see also* Overstreet, *supra*, at 162 (empirical evidence "suggests that neither supplier nor dealer collusion explanations are likely to apply to all or even most instances of price maintenance").

There is neither an empirical nor a theoretical basis to justify a ban on *all* uses of resale price maintenance out of a concern over potential collusive uses of the practice, which could only exist under specific and uncommon market conditions. To the contrary, the empirical evidence "suggest[s] that, on the margin, the dominant effect of a relaxation of the per se prohibition of RPM would be a reduction in the deterrence of noncollusive uses of RPM." Ippolito, *supra*, at 292. Moreover, this Court's precedents do not support applying a

per se rule that ensnares substantial procompetitive conduct simply out of fear of occasional anticompetitive uses. As discussed above, *per se* rules are appropriate *only* where a practice always, or almost always, results in anticompetitive effects. *See Sharp*, 485 U.S. at 723; Easterbrook, *supra*, at 142-43.

In any event, there is no reason to believe that the existing *per se* rules against horizontal collusion and the methods of detecting and punishing such collusion are so lacking as to justify additional *per se* rules as a prophylactic measure to bolster cartel enforcement. This Court addressed a similar issue in *Sylvania*, in which it noted that "[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers." 433 U.S. at 58 n.28. The Court concluded, however, that "we do not regard the problems of proof as sufficiently great to justify a *per se* rule." *Id.* The same reasoning requires rejection of the argument that a fear of cartels can support a *per se* rule against resale price maintenance.

4. Leegin's Use Of Resale Price Maintenance Illustrates The Procompetitive Purposes Of The Practice.

The facts of this case powerfully illustrate the competition-enhancing potential of resale price maintenance. Indeed, there is no allegation, or even a realistic possibility, that Leegin's conduct was part of a collusive horizontal scheme. *See* Elzinga Report at 14-18 (Pet. App. 31a-35a). There is also no evidence or suggestion that Leegin had market power. To the contrary, Leegin is but a small player in the fragmented and highly competitive marketplace for women's fashion accessories. *Id.* at 16-20 (Pet. App. 33a-37a).

If consumers are unhappy with the prices for Leegin's products, or if they do not want to pay for the promotional services stimulated by Leegin's pricing policy, they can buy fashion accessories from numerous other manufacturers at

numerous other retail outlets. *See* Elzinga Report at 19-20 (Pet. App. 36a-37a). Likewise, if Leegin's retail prices are too high, it will lose sales to its competitors and it will either lower its prices or lose substantial business. *See, e.g., Valley Liquors, Inc. v. Renfield Imps., Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982) ("A firm that has no market power is unlikely to adopt policies that disserve its consumers; it cannot afford to. And if it blunders and does adopt such a policy, market retribution will be swift."). On the other hand, if the combination of price and promotional services that results from Leegin's policy is attractive to consumers, then Leegin will increase its sales, competition will be enhanced, and consumers will benefit. There is simply no plausible scenario in which Leegin's pricing policy will have a substantial adverse effect in any relevant market. *See* Elzinga Report at 26-27 (Pet. App. 43a-44a).

Leegin used resale price maintenance in an attempt to bring new products and services to consumers and to enable small retailers to compete against prominent national brands sold through department stores and other large outlets. *See* Elzinga Report at 10-12 (Pet. App. 27a-29a). This case presents precisely the circumstances in which resale price maintenance can *enhance* interbrand competition and consumer welfare. Indeed, the fact that Leegin's output grew substantially while its pricing policy was in effect indicates strongly that competition was enhanced and that consumers have benefited from the policy. *Id.* at 20 (Pet. App. 37a); *see also* Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981) ("If [the defendant's] output expanded, the restriction must have made the firm's product more attractive to consumers on balance, thereby enabling the firm to take business from its competitors. This is an increase in interbrand competition and hence in consumer welfare, which is the desired result of competition."); Easterbrook, *supra*, at 163-64. Holding Leegin's conduct to be *per se* unlawful sti-

fles the competitive behavior of a small and innovative company, and thus conflicts with the objectives that this Court has sought to promote in interpreting the antitrust laws.

C. There Is No Judicial Experience With Resale Price Maintenance That Could Enable The Court To Predict With Confidence That The Rule Of Reason Will Condemn It.

This Court has often repeated that a *per se* rule is only appropriate "once experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (internal quotation marks and alteration omitted); *see also Broadcast Music, Inc. v. Columbia Broadcast Sys.*, 441 U.S. 1, 19 n.33 (1979). Continued adherence to the *per se* rule against resale price maintenance conflicts with this important criterion for the use of *per se* rules.

The rule of *Dr. Miles* was not the product of judicial experience evaluating resale price maintenance under the rule of reason. Indeed, the *Dr. Miles* Court offered no analysis of the practice's effect on competition or consumers, but instead simply applied the common-law prohibition on "restraints upon alienation," pursuant to which a "restraint in the alienation of articles . . . [was] generally held void." 220 U.S. at 404. And in the nearly 100 years since *Dr. Miles* was decided, the *per se* rule against resale price maintenance has prevented lower courts from developing experience in applying the rule of reason to assess resale price maintenance. *See* Ippolito, *supra*, at 268-69. In this case, for example, because of the rule of *Dr. Miles*, the district court conducted no analysis of the competitive effects of resale price maintenance on the marketplace, and it prevented Leegin from introducing any evidence or expert testimony regarding such effects.

Even more significantly, if courts *had* developed experience applying the rule of reason to resale price maintenance,

that experience would not have justified a *per se* rule—either at the time of *Dr. Miles* or today. For example, in the late 19th and early 20th centuries, a number of courts evaluated resale price maintenance under the rule of reason and concluded that the practice did *not* harm competition. As the Washington Supreme Court explained:

> In the absence of a monopoly . . . a contract fixing retail prices to the consumer cannot have an effect appreciably inimical to the public interest because it cannot fix prices at an unreasonably high figure without defeating its own purpose by either signally failing to maintain the fixed price, or putting the individual manufacturer out of business. . . . [I]t seems to us an economic fallacy to assume that the competition which, in the absence of monopoly, benefits the public, is competition between rival retailers. The true competition is between rival articles . . . .

Fisher Flouring Mills Co. v. Swanson, 137 P. 144, 148, 151 (Wash. 1913).[8]

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[8] *Accord Grogan v. Chaffee*, 105 P. 745, 747 (Cal. 1909) ("There is nothing either unreasonable or unlawful in the effort by a manufacturer to maintain a standard price for his goods. . . . Contracts similar to the one under discussion have been considered in a number of cases, and have generally been upheld . . . ."); *Walsh v. Dwight*, 58 N.Y.S. 91, 93-94 (App. Div. 1899) ("[A] contract by a single manufacturer as to the price at which his goods . . . should be sold . . . would not be a contract by which competition in the supply or price of the commodity would be restrained or prevented. All of the manufacturers could compete with these defendants in the sale of these goods . . . . That such an agreement is not illegal has been settled by a long line of authorities."); *see also* Louis D. Brandeis, *The Competition That Kills*, Harper's Weekly, Nov. 15, 1913, at 11 ("abundant experience establishes that the one-price system . . . [has] greatly increased the efficiency of merchandising not only for the producer, but for the dealer and the consumer as well").

More recently, this Court has pointed to the procompetitive virtues of vertical agreements that enhance interbrand competition and benefit consumers by "reduc[ing] intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services." *Sharp*, 485 U.S. at 728; *see also Monsanto*, 465 U.S. at 762-63 ("The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that 'free-riders' do not interfere."). As Justice White recognized in his concurrence in *Sylvania*, this is precisely the same economic effect that is fostered by resale price maintenance, and treating nonprice restraints under the rule of reason thus "call[s] into question" the rule of *Dr. Miles*. *Sylvania*, 433 U.S. at 69-70 (White, J., concurring).[9]

In light of the procompetitive benefits of resale price maintenance—which are the same benefits that motivated this Court in *Sylvania* to apply the rule of reason to nonprice agreements—the Court should hold that such arrangements are to be evaluated under the rule of reason, thus reconciling the conflict between *Dr. Miles*'s *per se* prohibition on resale

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[9] Several lower courts have likewise noted the substantial potential for resale price maintenance to be used for procompetitive purposes, and have questioned the continued *per se* treatment of the practice. *See, e.g.*, *Khan v. State Oil Co.*, 93 F.3d 1358, 1364 (7th Cir. 1996) (noting that the rule of *Dr. Miles* is not "easy to defend in terms of economic theory or antitrust policy"), *rev'd on other grounds*, 522 U.S. 3 (1997); *id.* ("[V]ertical minimum price fixing . . . does not impair any interest that the antitrust laws interpreted in light of modern economics could be thought intended to protect. It increases rather than reduces competition . . . ."); *Pace Elecs., Inc. v. Canon Computer Sys., Inc.*, 213 F.3d 118, 123 n.4 (3d Cir. 2000) (noting that "various scholars have taken issue with the Supreme Court's *per se* treatment of vertical minimum price fixing agreements and argued that these agreements may have significant, procompetitive attributes").

price maintenance and later decisions applying the rule of reason to analogous vertical agreements.[10]

II. CONTINUED ADHERENCE TO THE RULE OF *DR. MILES* WOULD HARM COMPETITION.

1. The *per se* rule of *Dr. Miles* compels manufacturers to resort to other restraints to achieve their desired mix of price and service promotion, such as establishing exclusive territories for dealers to prevent free-riding, integrating forward into distribution by performing wholesaling and retailing functions themselves, or contracting for particular sales-related services. These other tools, however, are not cost-

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[10] If the Court were to conclude that rule-of-reason treatment for all resale price maintenance agreements is inappropriate, and that *per se* treatment is warranted in some circumstances (a conclusion that we believe would be unjustified), the Court should apply such a *per se* rule only where there is a clear likelihood of anticompetitive effects. *See, e.g., Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 298 (1985) ("A plaintiff seeking application of the *per se* rule [against group boycotts] must present a threshold case that the challenged activity falls into a category likely to have predominantly anticompetitive effects."). For example, the Court has limited the *per se* rules against group boycotts and tying arrangements to cases in which the defendants possess market power, because, in the absence of market power, the conclusion that the practices are "virtually always likely to have an anticompetitive effect is not warranted." *Id.* at 296; *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 16-18 (1984); *see also infra* note 19. In contrast, the lower courts in this case applied the inflexible *per se* rule against resale price maintenance, with no analysis of the actual marketplace impact or whether Leegin had market power, no inquiry into Leegin's rationale for the practice, and no opportunity for Leegin to explain the procompetitive consequences of its actions. *See* Pet. App. 5a-6a. In this case, because Leegin is a small manufacturer with no market power and because there is no realistic threat that Leegin's use of resale price maintenance could have had anticompetitive effects, a narrowing of the *per se* rule along the lines of *Northwest Wholesale* or *Jefferson Parish* would require a reversal of the Fifth Circuit's decision.

free, and a legal regime that forces businesses to select second-best tools to achieve their competitive ends is inherently inefficient. *See* Posner, *Antitrust Law*, *supra*, at 185; Butz, *supra*, at 443-46, 457.[11] Continued adherence to the rule of *Dr. Miles* would thus force inefficient choices on businesses that would otherwise compete using resale price maintenance. *See* Butz, *supra*, at 447 (in choosing among options to limit control of their distribution systems, manufacturers "have incentives to adopt the lowest-cost approach"). The increased costs from such inefficiency are ultimately borne by consumers.

This is not to say that manufacturers will invariably employ resale price maintenance or that intrabrand price competition will disappear absent the *per se* rule of *Dr. Miles*. To the contrary, manufacturers will adopt resale price maintenance policies where it is efficient for them to do so to promote their products.[12] And where it is more efficient for manufacturers to encourage intrabrand price competition among their dealers, there is no reason for this form of competition to disappear in the absence of the rule of *Dr. Miles*. The key change is that manufacturers would have the ability

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[11] *See also, e.g., Dr. Miles*, 220 U.S. at 412 (Holmes, J., dissenting) ("The Dr. Miles Medical Company knows better than we do what will enable it to do the best business."); *Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1356-57 (9th Cir. 1982) ("[M]odern economic thought indicates that the invalidation of a distribution system, absent a showing of anti-competitive effect, may actually retard competition. Competition is promoted when manufacturers are given wide latitude in establishing their method of distribution . . . . Judicial deference to the manufacturer's business judgment is grounded in large part on the assumption that the manufacturer's interest in minimum distribution costs will benefit the consumer." (internal quotation marks omitted)).

[12] During the era in which state Fair Trade laws permitted resale price maintenance, economists estimate that "up to 10 percent of all retail products in the United States were subject to resale price floors." Winter, *supra*, at 61; *see also* Overstreet, *supra*, at 6-7 (same).

to select the most efficient and effective means of promoting their products from a menu of options that includes resale price maintenance. There is no reason for antitrust law to constrain that selection process by retaining the *per se* rule against resale price maintenance.

Significantly, the rule of *Dr. Miles* imposes a particularly heavy burden on the many small businesses or new entrants that would use resale price maintenance to compete against larger incumbents. *See, e.g., Sylvania*, 433 U.S. at 65 (White, J., concurring) ("the potential benefits of vertical restraints in promoting interbrand competition are particularly strong where the manufacturer imposing the restraints is seeking to enter a new market or to expand a small market share"). Smaller competitors—such as Leegin—could use resale price maintenance as a valuable tool to encourage retailers to promote their products. Such companies, however, may be unable to bear the added cost of using less efficient tools to achieve their competitive ends. *See, e.g.*, Butz, *supra*, at 456-57 ("policies designed to promote intrabrand price competition by restricting vertical price controls may force marginally profitable firms out of business, thereby reducing both product variety and interbrand competition"). By contrast, larger competitors may enjoy sufficient brand recognition and clout with retailers that they do not need to employ resale price maintenance; and where they need to enforce minimum resale prices, they may be better suited to bear the increased costs of alternative solutions (such as integrating forward into distribution) that are not subject to *per se* prohibition. *See, e.g.*, Brandeis, *supra*, at 12 ("The great corporation with ample capital . . . can establish its own agencies or sell direct to the consumer, and is in no danger of having its business destroyed by price-cutting among retailers. But the prohibition of price-maintenance imposes upon the small and independent producers a serious handicap."). A *per se* rule that favors larger incumbents at the expense of smaller competitors, new entrants, and innovators; that drives

marginal products out of the market and reduces product variety; and that incents manufacturers to integrate forward into distribution, rather than use independent distributors, is antithetical to any rational principle of antitrust law.

2. Contrary to PSKS's position, it is no cure for the ills of *Dr. Miles* that—rather than entering into an agreement with retailers establishing minimum resale prices for its goods—a manufacturer may unilaterally announce a suggested resale price and terminate noncompliant dealers under this Court's decision in *United States v. Colgate & Co.*, 250 U.S. 300 (1919). *See* Br. in Opp. to Pet. for Cert. 9. The *Colgate* doctrine is a blunt instrument that lacks the flexibility provided by a resale price maintenance policy.[13] For example, a manufacturer may find it more efficient to enter into an agreement with its dealers that governs the terms of their

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[13] The same is true with respect to vertical territorial restraints, which eliminate *all* intrabrand competition—a far more drastic reduction of competition than occurs with a restraint on intrabrand price competition. Indeed, resale price maintenance permits—and is often designed to encourage—nonprice competition among multiple sellers of a brand in the same geographic market. *See* Cert.-Stage Br. of *Amici Curiae* Economists 17. Resale price maintenance thus permits a manufacturer to make more finely-tuned adjustments to achieve the optimal level of intrabrand competition among its dealers. *See* Posner, *Antitrust Law*, *supra*, at 185. It makes no sense for the antitrust laws to evaluate a manufacturer's elimination of all intrabrand competition via vertical territorial restraints under the rule of reason, while treating a partial restriction on intrabrand competition via vertical price restraints as *per se* unlawful. Indeed, in *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 572 F.2d 883 (1st Cir. 1978), the court declined to treat a vertical price restraint as *per se* unlawful because it only applied to sales outside the dealer's assigned territory. The court saw "no reason based on substantive economic effect" why *per se* treatment would be appropriate because the restraint was less restrictive than a total ban on sales outside an assigned territory, which was subject to rule-of-reason treatment under *Sylvania*. *Id.*; *see also id.* at 885 (questioning how a price restraint on sales outside an assigned territory "can possibly have a greater anti-competitive effect than a pure policy of territorial restrictions").

relationship, rather than having no option but to terminate noncompliant dealers.

The natural reaction of a manufacturer seeking to enforce a *Colgate* policy with noncompliant dealers is often not simply to terminate the dealers, as is required under *Colgate*, but rather to work with its dealers to find a resolution that enables the parties to continue their business relationship. But in doing so, the manufacturer risks straying across the line between a unilateral policy that is protected by *Colgate* and a *per se* illegal agreement—a line that can be both uncertain and laden with trap doors that are not self-evident to a business person who is not well-schooled in the nuances of the *Colgate* doctrine. As a result, many businesses that rely on *Colgate* run the risk that a jury will later find that they crossed that line. Such a finding can be "based on insignificant—and often fortuitous—facts having little or nothing to do with" any sound principle of economics or antitrust law. Calvani & Berg, *supra*, at 1203; *see also* ABA Section of Antitrust Law, *Antitrust Law Developments* 18 (5th ed. 2002) [hereinafter *Antitrust Law Developments*] (collecting cases).

To mitigate this risk, many businesses spend significant resources hiring antitrust attorneys to implement "*Colgate* compliance" programs—the costs of which ultimately get passed through to consumers. *See* Cert.-Stage Br. of *Amicus Curiae* CTIA—The Wireless Association 12-13. Many other businesses that are deterred by the punitive consequences of the *per se* rule take pains to stay so far from the uncertain line between protected unilateral conduct and *per se* unlawful agreements that they refrain from engaging in procompetitive behavior that should not be deterred under any economically sound theory of antitrust law.

Moreover, the protection for unilateral action that is embodied in the *Colgate* doctrine simply reflects that Section 1 of the Sherman Act applies only to contracts, combinations, or conspiracies among two or more actors—not unilateral action. 15 U.S.C. § 1. The issue at hand is not whether uni-

lateral action in restraint of trade should be subject to liability (Congress has decided that issue), or whether there was an agreement here (the jury has decided that issue), but rather the appropriate standard for determining whether a resale price maintenance agreement is *unreasonable*. The *per se* rule of *Dr. Miles* is an inappropriate standard for making that determination. It does not salvage that erroneous standard to argue that unilateral action is outside the scope of Section 1.

III. THE ARGUMENTS FOR RETAINING THE RULE OF *DR. MILES* ARE INSUFFICIENT TO JUSTIFY ITS CONTINUED EXISTENCE.

PSKS has defended the rule of *Dr. Miles* based on considerations of *stare decisis* and deference to various congressional actions (or inactions) that did not actually require continued *per se* treatment of resale price maintenance. This Court has previously rejected such arguments in overturning analogous *per se* rules, and it should similarly reject these considerations in its evaluation of the rule of *Dr. Miles*.

A. *Stare Decisis* Is Not A Basis For Leaving Outdated *Per Se* Rules In Place.

In *Khan*, this Court expressly rejected the argument that it should leave undisturbed the antiquated and economically unsound *per se* rule against vertical maximum price agreements based on considerations of *stare decisis*. 522 U.S. at 20-21. The Court explained that "*stare decisis* is not an inexorable command" and that, "[i]n the area of antitrust law, there is a competing interest, well-represented in this Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Id.* at 20. Similarly, in *Sharp*, the Court recognized that "[t]he Sherman Act adopted the term 'restraint of trade' along with its dynamic potential," and therefore the "line of *per se* illegality" should not "remain[] forever fixed where it was" when the Sherman Act was enacted in 1890. 485 U.S. at 732.

This understanding of the dynamic nature of the Sherman Act is faithful to Congress's intent, and it has been an important part of the Court's antitrust jurisprudence for well over a century. *See, e.g.*, 21 Cong. Rec. S2460 (daily ed. Mar. 21, 1890) (statement of Sen. Sherman) (noting that the courts should "determine in each particular case" the "precise line between lawful and unlawful combinations").[14] Indeed, in *Dr. Miles* itself, the Court stated that, "[w]ith respect to contracts in restraint of trade, the earlier doctrine of the common law has been substantially modified in adaptation to modern conditions." 220 U.S. at 406; *accord Khan*, 522 U.S. at 21. Nothing in the Sherman Act or the history of this Court's jurisprudence requires that the "adaptation to modern conditions" be frozen in place in 1911.

B. Congress Has Never Required Adherence To The Rule Of *Dr. Miles*.

PSKS has placed heavy reliance on arguments that the *per se* rule of *Dr. Miles* should be retained because of various actions or inactions by Congress over the course of the last century. Br. in Opp. to Pet. for Cert. 11-15. This argument misconstrues the action that Congress has taken in this area.

Congress's failure to legislatively overturn the rule of *Dr. Miles* warrants little weight. Indeed, this Court expressly

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[14] *See also, e.g., Guardians Ass'n v. Civil Serv. Comm'n*, 463 U.S. 582, 641 n.12 (1983) (Stevens, J., dissenting) ("Congress phrased some older statutes in sweeping, general terms, expecting the federal courts to interpret them by developing legal rules on a case-by-case basis in the common law tradition. One clear example of such a statute is the Sherman Act. For that reason, in [*Sylvania*], the doctrine of *stare decisis* did not preclude the Court from overruling its prior decision in [*Schwinn*], even though Congress had not acted in the intervening decade." (citations omitted)); *Tex. Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1981) (Congress's intent in passing the Sherman Act "to allow courts to develop governing principles of law[] [is] unmistakably clear"); Easterbrook, *supra*, at 136-38.

rejected an argument based on congressional inaction in *Khan*, stating that "we infer little meaning from the fact that Congress has not reacted legislatively to *Albrecht*." 522 U.S. at 19. The Court explained that "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition." *Id.* at 20 (internal quotation marks omitted).[15]

The proper focus is not on any "inaction" by Congress, but whether Congress has taken any action to deny this Court its traditional role of "giv[ing] shape to the [Sherman Act's] broad mandate" in light of "the lessons of accumulated experience." *Khan*, 522 U.S. at 20. Congress has not taken such action with respect to resale price maintenance. In particular, Congress has *never* passed legislation requiring that resale price maintenance be treated as *per se* unlawful. To be sure, resale price maintenance has been a subject of congressional action on several occasions. In 1937 and 1952, Congress passed legislation that removed resale price maintenance contracts from the reach of the Sherman Act if such contracts were valid under state laws. *See* Miller-Tydings Fair Trade Act, Pub. L. No. 75-314, 50 Stat. 693 (1937); McGuire Act, Pub. L. No. 82-542, 66 Stat. 631 (1952). In 1975, Congress repealed these acts. *See* Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801. The 1975 Act did *not*, however, require that resale price maintenance be deemed *per se* unlawful. Congress simply repealed an antitrust exemption and restored the ordinary state of anti-

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15 *See also Nat'l Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 688 (1978) ("Congress . . . did not intend the text of the Sherman Act to delineate the full meaning of the statute or its application in concrete situations. The legislative history makes it perfectly clear that it expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.").

trust law—judicial interpretation of what constitutes an unlawful "restraint of trade." *See* Posner, *Antitrust Law*, *supra*, at 189 ("Congress's action in repealing an antitrust immunity for resale price maintenance was not the same thing as outlawing the practice."); Easterbrook, *supra*, at 139-40. This legislation provides no basis to freeze in place the *per se* rules that existed in 1911, 1975, or any other year.

PSKS has also pointed to a handful of additional measures that Congress has considered or passed in the last three decades; but, again, none of these measures limits this Court's mandate to determine what conduct constitutes an unlawful restraint of trade. For example, in the mid-1980s, Congress twice prohibited the Department of Justice from using appropriations to advocate for a reversal of the *per se* rule against resale price maintenance. *See* Pub. L. No. 99-180, 99 Stat. 1136, 1169 (1985); Pub. L. No. 98-166, 97 Stat. 1071, 1102 (1983). The appropriation provisions were not repeated in the next budget, and they have not been repeated since. That these budgetary restrictions were not renewed, and that no similar restraints have been in place for a number of years, suggests, if anything, that Congress deemed them undesirable after the short period in which they were in place. This hardly seems to be a basis to disrupt this Court's longstanding mandate to interpret the Sherman Act.

That Congress has not enacted legislation to take away this Court's power to interpret the antitrust laws simply underscores the propriety of the approach to the Sherman Act that this Court has pursued for a century. *See* Cert.-Stage Br. of *Amicus Curiae* CTIA—The Wireless Association 17-18. As Chief Justice White wrote in the year that *Dr. Miles* was decided, the Court should continue to interpret the standards for what constitutes an unlawful restraint of trade as its understanding of what makes a restraint "unreasonable" evolves. *Standard Oil Co. v. United States*, 221 U.S. 1, 63-64 (1911).

IV. THE LOWER COURTS ARE FULLY CAPABLE OF APPLYING THE RULE OF REASON TO RESALE PRICE MAINTENANCE AGREEMENTS.

PSKS has argued that the rule of *Dr. Miles* should be retained because it is "clear and easily enforceable." Br. in Opp. to Pet. for Cert. 21. Any efficiency benefits of *per se* treatment, however, cannot justify a sweeping and overbroad rule that condemns a significant amount of procompetitive behavior. As this Court has repeatedly reaffirmed, antitrust *per se* rules must be limited to practices that "always or almost always tend to restrict competition and decrease output." *Broadcast Music*, 441 U.S. at 19-20. That condition is not met here.

Moreover, it is doubtful whether there actually are any efficiency benefits resulting from the rule of *Dr. Miles*. First, overturning the rule of *Dr. Miles* would likely lead to a reduction in the number of resale price maintenance cases that are filed. The *per se* rule encourages disgruntled distributors to bring antitrust lawsuits even where a vertical restraint can have no conceivable negative effect on competition in a relevant market. If distributors were required to demonstrate an effect on competition, it is likely that fewer economically groundless lawsuits attacking vertical pricing practices would be brought, easing any burden on the courts from resale price maintenance cases. *See* Cert.-Stage Br. of *Amicus Curiae* CTIA—The Wireless Association 11.

Second, following *Sylvania*, the lower courts have demonstrated their ability to apply an efficient rule-of-reason analysis to vertical nonprice agreements, which have effects on competition that are analogous to resale price maintenance agreements. *See Monsanto*, 465 U.S. at 762. In doing so, the courts have established a number of criteria that should be guideposts for courts evaluating resale price maintenance agreements under the rule of reason.

For example, plaintiffs challenging vertical nonprice restraints must establish that the restraint had a substantial adverse effect on interbrand competition in a relevant market.[16] Merely establishing some negative effect on intrabrand competition is typically insufficient to demonstrate that a vertical restraint is unreasonable.[17] In examining the effect of a vertical restraint on competition, lower courts take into account the restraint's impact not only on price, but also on service, quality, and other dimensions of competition.[18]

In addition, to establish that the manufacturer has the ability to bring about a substantial adverse effect on interbrand competition through a vertical restraint, lower courts ordinarily have required plaintiffs to make a threshold showing that the manufacturer has market power.[19] Where the

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16 *See, e.g., Schwinn*, 388 U.S. at 374 n.5, 375 ("Our inquiry is whether . . . the effect upon competition in the marketplace is substantially adverse."); *see also Antitrust Law Developments, supra*, at 61-62 (collecting cases).

17 *See, e.g., Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1231 (8th Cir. 1987); *Valley Liquors*, 678 F.2d at 745; *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 298 (5th Cir. 1981); *see also Antitrust Law Developments, supra*, at 155 n.878 (collecting cases).

18 *See, e.g., Valley Liquors*, 678 F.2d at 745; *Muenster Butane*, 651 F.2d at 298.

19 *See, e.g., Assam Drug Co. v. Miller Brewing Co.*, 798 F.2d 311, 316 (8th Cir. 1986) ("Firms lacking market power, if they wish to survive, cannot adopt restraints that have anticompetitive effects. Thus such firms cannot have an effect on interbrand competition. Consequently, a finding of no market power precludes any need to further balance the competitive effects of a challenged restraint."); *see also Murrow Furniture Galleries, Inc. v. Thomasville Furniture Indus., Inc.*, 889 F.2d 524, 529 (4th Cir. 1989); *Ryko Mfg.*, 823 F.2d at 1231; *Rothery Storage & Van Co. v. Atlas Van Lines, Inc.*, 792 F.2d 210, 221 (D.C. Cir. 1986); *Valley Liquors*, 678 F.2d at 745; *Muenster Butane*, 651 F.2d at 298; Frank H. Easterbrook, *The Limits of Antitrust*, 63 Tex. L. Rev. 1, 20 (1984) ("Firms that lack [market] power cannot injure competition no matter how hard they try. They may injure a few consumers, or a few rivals, or themselves . . . .

manufacturer does not have a substantial share of the market, courts have regularly granted judgment as a matter of law to the manufacturer because it is unlikely that the limitations on intrabrand competition will impair interbrand competition.[20] As this Court has explained, "when interbrand competition exists . . . it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." *Sylvania*, 433 U.S. at 52 n.19.

If the plaintiff meets its initial burden to demonstrate a substantial adverse effect on competition in the relevant market, then the defendant may show that the restraint is reasonably necessary to achieve a procompetitive objective, and the court then balances the restraint's negative effects on intrabrand competition and its positive effects on interbrand competition in the relevant market to determine whether the net overall effect on competition is substantially adverse.[21]

Applying this framework to resale price maintenance cases would likely permit a *more* efficient resolution of many such cases than is generated by the *per se* rule of *Dr. Miles*. In particular, where a claim would be subject to judgment as a matter of law for failure to make a threshold showing of

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[Footnote continued from previous page]

When the firms lack market power, though, they cannot persist in deleterious practices. Rival firms will offer the consumers better deals. Rivals' offers will stamp out bad practices faster than the judicial process can.").

20 *See, e.g., Ryko Mfg.*, 823 F.2d at 1231 & n.14; *Assam Drug*, 798 F.2d at 317-18; *Rothery Storage*, 792 F.2d at 221; *JBL Enters., Inc. v. Jhirmack Enters., Inc.*, 698 F.2d 1011, 1017 (9th Cir. 1983); *Muenster Butane*, 651 F.2d at 298; *see also Antitrust Law Developments*, *supra*, at 156 n.879 (collecting cases).

21 *See, e.g., Sylvania*, 433 U.S. at 51-59; *Valley Liquors*, 678 F.2d at 745; *Krehl*, 664 F.2d at 1356-57; *Muenster Butane*, 651 F.2d at 296-98; *Red Diamond Supply, Inc. v. Liquid Carbonic Corp.*, 637 F.2d 1001, 1005-07 (5th Cir. 1981).

market power or a substantial adverse effect on competition—which is an issue that can often be resolved more easily than a determination whether communications between a supplier and its dealers constitute an "agreement" under Section 1 of the Sherman Act—there would be no need to conduct a trial to determine whether there was in fact an agreement between the manufacturer and its retailers.[22]

The present case vividly illustrates the potential efficiencies to be gained by eliminating the rule of *Dr. Miles*. If PSKS had been required to demonstrate that Leegin's vertical pricing policy had a substantial adverse effect on competition in the market for women's fashion accessories (in which Leegin is a tiny player in a fragmented marketplace), Leegin would have been entitled to judgment as a matter of law on that element of PSKS's claim, and the case would not have gone to trial on the question whether Leegin had entered into a pricing agreement with its distributors.

V. THE COURT SHOULD REVERSE THE DECISION BELOW.

If this Court determines that resale price maintenance agreements should no longer be subject to *per se* treatment, it should reverse the decision below because this case was litigated solely under the *per se* rule of *Dr. Miles*. Indeed, the district court refused to allow Leegin to introduce evidence that its pricing policy promoted competition, it excluded the

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22 *See, e.g., Bi-Rite Oil Co. v. Ind. Farm Bureau Coop. Ass'n*, 908 F.2d 200, 202 (7th Cir. 1990) (district court found that plaintiff had raised sufficient facts to withstand a summary judgment motion on the conspiracy element of its challenge to vertical nonprice restraints, but granted summary judgment in favor of defendants on the "unreasonableness" element of the claim); *Muenster Butane*, 651 F.2d at 298 ("A requirement that plaintiff prove market power in this case would have saved the litigants and the courts much expense. . . . Whatever vertical restraints Stewart imposed on its dealers, their effect could not have been to raise the price consumers paid for television sets.").

report of Leegin's economic expert on the basis that the conduct at issue was a *per se* unlawful resale price maintenance agreement, it denied Leegin's request for an instruction that the jury apply the rule of reason, and it denied Leegin's motion for judgment as a matter of law based on the rule of *Dr. Miles*. Similarly, the court of appeals affirmed the judgment against Leegin in reliance upon the *per se* rule against resale price maintenance, stating that lower courts "remain bound by [the Supreme Court's] holding in *Dr. Miles*." Pet. App. 4a. In the absence of the *per se* rule applied by the lower courts, the decision below cannot stand.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

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January 22, 2007

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC. D/B/A KAY'S KLOSET...KAY'S SHOES,
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On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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RULE 29.6 STATEMENT

The corporate disclosure statement included in the Brief in Opposition on Petition for Writ of Certiorari remains accurate.

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IN THE

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Petitioner,

v.

PSKS, INC. D/B/A KAY'S KLOSET...KAY'S SHOES,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENT

STATEMENT OF THE CASE

1. Notwithstanding that vertical minimum price fixing agreements have been illegal *per se* since 1911, Leegin embarked on a plan to enter written agreements with its key retailers fixing the resale price of Brighton goods. In 1998, Leegin induced those retailers to sign and return a "Brighton Pledge" form in which retailers agreed to abide by Leegin's pricing policy and pledged to "Follow the Brighton Suggested Pricing Policy at all times." (4 R. 972). In the years that followed, Leegin sought, and retailers executed and returned "Brighton Heart Store Agreements" in which retailers agreed to "Sell Brighton products for the suggested price every day, 365 days a year." (4 R. 984). Leegin continued the Heart Store program through the time of trial, requiring "Heart Store" retailers to sign and return a new agreement each year.

Leegin and a number of retail outlets that exclusively featured the Brighton line of products shared common ownership. (5 R. 53) In addition, Leegin licensed a number of other retailers the right to use the Brighton name as a part of their store name. Leegin requires both its commonly owned stores and the independent "Brighton" stores to execute Trademark License agreements. Those agreements bound the licensee to comply with Leegin's pricing and promotional policy. (P. Ex. 114).[1]

Leegin enforced the price fixing agreements against all of its retailers. Jerry Kohl, Leegin's president and owner, testified: "[W]e require every one of our customers, whether they are a Heart Store or a Brighton Collectibles store or a store, as you classify, independent retailers, we require everybody to charge the same price." (5 R. 75-76). Leegin's enforcement efforts took the form of threats to stop shipment, suspensions of shipment pending agreement to raise prices, or, as in Kay's Kloset's case, complete cessation of shipments. (5 R. 83, 6 R. 45-46, 50, 54-56).

At trial, Kay's Kloset proved that this series of contracts—and not some "policy"—constituted illegal price fixing that violated the clear and consistent holdings of this Court that such contracts are illegal *per se*. In this case there is no dispute that Leegin made a conscious and determined choice to enter price fixing contracts with retailers across the nation, and to enforce those agreements.

2. Not only does Leegin manufacture and sell its merchandise to independent retailers, it owns and operates its largest stores. At the time of the trial, Leegin shared common ownership with Brighton Retail, a company that owned fifty Brighton only retail stores, and with Corazon, a company

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[1] In addition, Leegin required retailers that wished to sell Leegin's luggage to execute a separate "Luggage Agreement" that obligated the retailers to offer that luggage "at the suggested retail price." (P.Ex. 39)

that owned twenty-one retail stores in four states. (5 R. 52, 55). Those seventy-plus stores, along with the Heart Stores, accounted for a substantial share of Leegin's total sales. (5 R. 60, 123). Several of Leegin's stores were in the Dallas, Texas area, and at least one of them competed directly with Kay's Kloset. (10 R. 11).

By operating its own retail outlets in the best locations (i.e., those locations that can support a stand-alone store exclusively dedicated to Brighton products), Brighton became its own best customer at the retail level. Under these circumstances, Brighton's price fixing agreements effectively constitute a horizontal retailer cartel. Brighton could set the prices above market, and avoid intrabrand competition by securing price fixing agreements with the largest independently owned stores, and forbidding discounting by all retailers.

Indeed, there was ample evidence that Leegin was directing a collusive, horizontal scheme to fix prices at the retail level. The record below shows that Leegin paid for trips for representatives of its largest retailers to meet in Hawaii. Anne Wolfe, one of those retailers, testified about one of those meetings. She described a discussion in a session led by Leegin about pricing practices among Brighton dealers. Those present at the session reached a consensus about Leegin's pricing practices. That cartel agreement was then approved by Jerry Kohl, who owned Leegin and its Brighton Stores. (9 R. 119-24). In an e-mail, Jerry Kohl stated: "What we have decided is OK after talking to more than 100 retailers is a birthday Club that on your birthday (or within a short time of your birthday) a consumer can get a discount on 1 piece of merchandise in your store (everything not only Brighton)." (P. Ex. 73). Leegin implemented the agreement in its own stores, and enforced it against all other stores.

Other evidence showed Leegin acting as a hub in a classic spoke-and-hub horizontal price fixing conspiracy, by serving as a middle man to make agreements between competing

stores that wanted to engage in price competition. Leegin's sales representative disclosed how Leegin management would "try and work up some agreement from the middle man. I mean, maybe this will blow up and * * * they'll discuss it with [one retailer]. They'll discuss it with the [the other retailer], you know, make everybody play by the rules." (7 R. 95).

Leegin undertook to suppress competition among retailers in other ways. Jerry Kohl referred repeatedly to this theme in e-mails. For example, he noted that if gift-with-purchase giveaways were permitted, "the other retailers in the area feel they have to compete and before long its [sic] chaos." (P. Ex. 74). Laura Young, Leegin's second-in-command and the person in charge of the Brighton line, declared that discounting activities would "spread like cancer," (P. Ex. 67) and that retailer competition would result in a situation that would be "out of control." (P. Ex. 74).

As a retailer, Leegin had every incentive to undermine competition in the pricing of Brighton products. The manager of Leegin's retail stores testified that fixed minimum prices improved Leegin's profitability and helped Leegin's retail stores "be profitable for a long period of time." (9 R. 64-65).

3. Kay's Kloset is a women's specialty store that operated in the Dallas suburb of Lewisville, Texas.[2] Since it opened in 1986, it has been engaged in the retail sale of women's fashions, shoes, and accessories. In 1995, Kay's Kloset began offering the Brighton line of products. (7 R. 60). At its own expense, Kay's Kloset advertised and promoted the Brighton brand, spending tens of thousands of dollars on television, newspaper and direct mail ads. (7 R. 61-62). As a result, Kay's Kloset became the place to purchase Brighton in its market area. (7 R. 63).

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[2] Since trial, it has moved approximately two miles to a smaller store in the neighboring town of Flower Mound.

In December 2002, Leegin ceased supplying Brighton products to Kay's Kloset, solely because Kay's was selling Brighton products at prices as much as 20% below Leegin's fixed retail price. The only reason Leegin ever gave for the termination was that Kay's Kloset was selling Brighton below Leegin's fixed price. (6 R. 50). As a result of Leegin's actions, Kay's Kloset lost substantial profits it would have earned selling Brighton products. Because it no longer could offer those products, Kay's Kloset lost all benefit of its large investment in promoting the Brighton brand.

SUMMARY OF ARGUMENT

Vertical minimum price fixing, or resale price maintenance ("RPM"), has been *per se* illegal since the Court's decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). The doctrine of *stare decisis* counsels against overruling century-old, repeatedly reaffirmed precedent absent "special justification," which simply does not exist in this case. *See Dickerson v. United States*, 530 U.S. 428, 443 (2000).

Congress repeatedly has reaffirmed its support of the *per se* rule as furthering the primary antitrust policy objective of lowering prices for consumers. In passing the Consumer Goods Pricing Act of 1975, Congress repealed the Miller-Tydings and McGuire Acts, removing exemptions that permitted states to enact legislation allowing RPM agreements. Both Congress and President Ford made clear that the 1975 Act endorsed the *Dr. Miles* rule and continued to make RPM agreements illegal.

The Court previously has acknowledged that these actions signaled Congressional support for the *per se* rule. *See Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n.18 (1977). Since passing the 1975 Act, Congress has shown its continued support for the rule, repeatedly acting to restrict activities of the Department of Justice aimed at overturning

the *per se* rule. Given Congress's strong and clear support for the *per se* rule, the Court should defer to Congress as the body ultimately responsible for determining antitrust policy.

Both the retail segment of the economy and consumers have relied upon the *Dr. Miles* rule. The structure and nature of the American economy is shaped by consumers' desire for lower prices, and retailers' willingness to achieve economies and pass savings on to consumers. Overturning *Dr. Miles* would unsettle the way products are now distributed and priced in this country.

Leegin's arguments for overturning the *per se* rule against vertical minimum price maintenance agreements are based entirely and only upon theories, and not upon demonstrable economic evidence. Empirical studies show that RPM increases prices to consumers, but no study has ever shown that consumers benefit in any way from the imposition of resale price floors. In fact, guaranteed profit margins under resale pricing agreements may serve as a disincentive to dealer innovation in resale practices, and may force many consumers to pay for services that they do not want, do not need and may not receive.

The only uniform and demonstrable effect of RPM is higher consumer prices. This Court should apply the same fundamental principle it recently relied upon in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, No. 05-381, slip op. at 6 (U.S. Feb. 20, 2007): "'[D]iscouraging a price cut and * * * depriving consumers of the benefits of lower prices * * * does not constitute sound antitrust policy.'" (quoting, *Brook Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)).

In addition to manufacturing and distributing its products, Leegin was a dealer of the same products at the retail level. Leegin's participation in the retail market adds the element of collusion to fix prices horizontally with its other retail

competitors. For this reason, the present case is distinguishable from *Dr. Miles*. Liability at trial was still appropriately judged based on the *per se* standard as required by the long-standing prohibition against horizontal cartels. The verdict below can be affirmed on this ground as well.

ARGUMENT

I. TRADITIONAL *STARE DECISIS* PRINCIPLES COMPEL RETAINING THE *PER SE* RULE

Stare decisis is "the basic legal principle that commands judicial respect for the court's earlier decisions and the rules of law they embody." *Randall v. Sorrell*, 126 S.Ct. 2479, 2489 (2006); *Harris v. United States*, 536 U. S. 545, 556–557 (2002). The integrity of the judicial process depends on the proper application of *stare decisis* and its ability to "promote[] the evenhanded, predictable, and consistent development of legal principles [and] foster[] reliance on judicial decisions." *Sorrell*, 126 S.Ct. at 2489 (internal quotations omitted). The Court long has recognized that even though there are times when *stare decisis* cannot justify the continuance of an outmoded rule of law, "the doctrine carries such persuasive force that [the Court] has always required a departure from precedent to be supported by some 'special justification.'" *Dickerson*, 530 U.S. at 443 (quotations omitted).

A "special justification" is "especially necessary where, as here, the principle has become settled through iteration and reiteration over a long period of time." *Sorrell*, 126 S.Ct. at 2489 (citations omitted). The Court, as recently as 1997, recognized that agreements to maintain minimum pricing "remain illegal *per se*." *State Oil Co. v. Khan*, 522 U.S. 3, 17 (1997); *see also NYNEX Corp. v. Discon. Inc.*, 525 U.S. 128, 138 (1998) ("vertical price fixing * * * may fall within the scope of a *per se* rule * * * "). Indeed, despite numerous opportunities to examine the continuing appropriateness of the *per se* rule, the Court has distinguished the application of

the *per se* rule against vertical minimum resale price maintenance from application of *per se* rules against other vertical restraints. The rule enunciated in *Dr. Miles* is certainly one that has "become settled through iteration and reiteration over a long period of time."

No "special justification" exists to merit the extraordinary departure from *stare decisis* that the Petitioner requests in this case. *Dr. Miles* has been settled precedent for nearly 100 years, and experience with the *per se* rule has served to establish its correctness. The long-standing application of the *per se* rule against vertical minimum RPM has created "settled legal expectations." To overturn or alter the rule now would create just the "instability and unfairness" that *stare decisis* is designed to avoid. *Sorrell*, 126 S.Ct. at 2489; *United States v. Int'l Business Machs. Corp.*, 517 U.S. 843, 856 (1996).

"Considerations of *stare decisis* are particularly forceful in the area of statutory construction, especially when a unanimous interpretation of a statute has been accepted as settled law for several decades." *IBP, Inc. v. Alvarez*, 126 S. Ct. 514, 523 (2005). The rule of *stare decisis* in statutory cases is "almost categorical," and departure from it is "always extraordinary." *Rasul v. Bush*, 542 U.S. 466, 493, 506 (2004) (Scalia, J., dissenting). *Stare decisis* is at its strongest where Congress has been invited to and free to change the Court's interpretation of a statute through legislation, but has declined to do so. *Hubbard v. United States*, 514 U.S. 695, 711-12 (1995); *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977).

The force of *stare decisis* is particularly strong in this case because Congress has actually legislated with respect to RPM. The passage of the Miller-Tydings and McGuire Acts, and their subsequent repeal by the Consumer Goods Pricing Act of 1975, evidence explicit Congressional approval of the Court's interpretation of the Sherman Act in *Dr. Miles*. Congress's clear endorsement of the *per se* rule against RPM has established that rule as "settled law." *Alvarez*, 126 S. Ct. at 523.

Because *Dr. Miles* has been the controlling law for almost a century, the closest precedent to this case is the Court's treatment of the baseball antitrust exemption. In *Federal Baseball Club v. National League*, 295 U.S. 200 (1922), the Court held that baseball was not subject to challenge under the Sherman Act. That holding was subject to application and reconsideration in cases that followed.

In *Toolson v. New York Yankees, Inc.*, the Court declined to overturn *Federal Baseball* and observed that:

> Congress has had the ruling under consideration but has not seen fit to bring such business under these laws by legislation having prospective effect. The business has thus been left for thirty years to develop, on the understanding that it was not subject to existing antitrust legislation. The present cases ask us to overrule the prior decision and, with retrospective effect, hold the legislation applicable. We think that if there are evils in this field which now warrant application to it of the antitrust laws it should be by legislation.

346 U.S. 356, 357 (1953) (emphasis added).

The Court further explained that rationale in *United States v. Shubert*, decided a year later, and reiterated that the application of *stare decisis* in the *Toolson* case was proper because "Congress, although it had actively considered the ruling, had not seen fit to reject it by amendatory legislation." 348 U.S. 222, 229 (1955) (emphasis added). The Court added that "[i]f the *Toolson* holding is to be expanded—or contracted—the appropriate remedy lies with Congress." *Id.* at 230.

The Court has acknowledged that its ruling regarding baseball's antitrust exemption may be "unrealistic, inconsistent, or illogical." *Radovich v. National Football League*, 352 U.S. 445, 452 (1957). Nevertheless, the Court deemed the rule "fully entitled to the benefit of *stare decisis*" and upheld the rule even though multiple consecutive cases found the rule to

be inapplicable to every business except baseball.[3] *Flood v. Kuhn*, 407 U.S. 258, 282 (1972). The Court has continued to uphold *Toolson* despite its rulings in numerous cases that would call that holding into question, because it has been "loath * * * to overturn those cases judicially when Congress, by its positive inaction, has allowed those decisions to stand for so long and, far beyond mere inference and implication, has clearly evinced a desire not to disapprove them legislatively." *Id.* at 283-84. The remedy for any illogic or inconsistency in those results has been left to Congress because "[u]nder these circumstances, there is merit in consistency even though some might claim that beneath that consistency is a layer of inconsistency." *Id.* at 284.

In fact, three of the primary reasons the Court advanced in *Flood* for applying *stare decisis* were as follows: 1) Congressional awareness of the rule combined with Congressional inaction regarding the rule; 2) the development of the baseball industry in reliance on the rule; and 3) the continued belief that Congress was the appropriate body to overturn existing law, should a change be warranted. 407 U.S. at 283-84.

The same justifications that support adherence to the baseball exemption apply with greater weight in this case.

A. Congress Has By Action And Inaction Endorsed The *Per Se* Rule Against Resale Price Maintenance

Although the legislative intent behind the Sherman Act is somewhat cloudy, the *Dr. Miles* interpretation of the Sherman

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[3] See, e.g., *Radovich v. National Football League*, 352 U.S. 445 (1957) (holding that professional football is subject to the antitrust laws); *United States v. Int'l Boxing Club of New York*, 348 U.S. 236 (1955) (holding that the sport of boxing is subject to the antitrust laws); *United States v. Shubert*, 348 U.S. 222 (1955) (holding that the theatrical business is subject to antitrust scrutiny).

Act appears consistent with Congress's original intent.[4] Since *Dr. Miles*, Congress has been active in setting antitrust policy for RPM. "Congress has revisited the area of resale price maintenance regularly—almost in clockwork 20-year cycles—with special attention to the empirical effects of the policy on consumers and interstate commerce." H.R. Rep. No. 237, 102nd Cong., 1st Sess., at 4 (1991). Throughout this time, Congress consistently and unambiguously has recognized the *Dr. Miles per se* prohibition of RPM and relied upon that rule.

1. *Congress Established RPM Policy When It Permitted Fair Trade Laws*

During the Depression, and at the behest of retail trade associations, generally comprised of small, inefficient retailers facing competition from more efficient retailers, Congress passed the Miller-Tydings Act. Act of August 17, 1937, ch. 690, 50 Stat. 693, 15 U.S.C.A. § 1; *See also* Lawrence Anthony Sullivan, Handbook of the Law of Antitrust §132, at 378 (West 1977). That Act was passed in response to state "fair trade" laws, which authorized agreements between manufacturers and retailers fixing the price at which the retailer could resell certain products. In adopting this Act, Congress recognized that, in the Act's absence, these agreements would be in violation of the *Dr. Miles* prohibition. The Miller-Tydings Act exempted such agreements from the Sherman Act so long as they met certain criteria and were authorized by state law.

In 1951, the Court held that fair trade agreements could not be enforced against non-signing third parties without violating the *Dr. Miles* rule. *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951). In response, Congress passed the McGuire Act, permitting states to enact laws

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[4] See David H. Marks & Jonathan M. Jacobson, *Price Fixing: An Overview*, 30 Antitrust Bulletin, 199, 227-28 (1985), *citing*, 51 Cong. Rec. 4089-90 (1890).

authorizing RPM agreements to be enforced against non-signing third parties. Act of July 14, 1952, ch. 745, 66 Stat. 632, 15 U.S.C.A. § 45(a). These two Congressional acts, permitting limited exceptions to the *Dr. Miles* rule, were wholly unnecessary unless Congress understood and agreed that RPM agreements were illegal *per se*. Notably, in adopting these exemptions, Congress did not purport to alter *Dr. Miles* in any way.

2. *Congress Ultimately Rejected State Fair Trade Laws And Reiterated Its Endorsement Of The* Per Se *Rule*

Congress' experimentation with fair trade and legalized RPM proved very costly to consumers. Studies the Department of Justice conducted in the late 1960s indicated that "fair trade" laws cost consumers in the United States at least $2.1 billion and were estimated to have raised prices on fair traded goods between 18 and 27 percent. S. Rep. No. 466, 94th Cong., 1st Sess., at 3 (1975). Consequently, in the mid-1970s President Ford, the Department of Justice, the Federal Trade Commission, the Council on Wage and Price Stability, discount retailers, small business associations, and consumer groups called for repeal of the Miller-Tydings and McGuire Acts. *Id.* Congress responded, passing in 1975 "An act to amend the Sherman Antitrust Act to provide lower prices for consumers," more commonly known as the Consumers Goods Pricing Act of 1975. Pub. L. No. 94-145, 89 Stat. 801 (codified at 15 U.S.C.A. § 1)(emphasis added).

The long title of the Act demonstrated Congress's overriding policy goal: to provide lower prices for consumers. To accomplish this goal, the Act repealed the Miller-Tydings and McGuire Acts, thus again subjecting RPM agreements to the *Dr. Miles*, *per se* rule. Thus, Congress expressly declared its intent to return to the *Dr. Miles* standard. The Senate Judiciary Committee Report stated that "[w]ithout these exemptions the agreements they authorize would violate the antitrust

laws." S. Rep No. 466, at 1. The Committee Report labeled fair trade laws "legalized price fixing" and affirmed its intention that "repeal of the fair trade laws generally will prohibit manufacturers from enforcing resale prices * * * ." *Id.* at 2-3. President Ford wrote in his signing statement that the Act would "make it illegal for manufacturers to fix the prices of consumer products sold by retailers." President Gerald R. Ford, Statement on the Consumer Goods Pricing Act of 1975 (Dec. 12, 1975) *available at* http://www.presidency.ucsb.edu/ws/index.php?pid=5432.

More particularly, President Ford emphasized Congress's goal of achieving lower prices for consumers, observing:

> [The fair trade laws] prevent the American people from receiving the benefit of lower prices on cameras, watches, sporting goods, small appliances, auto supplies, and many other brand name products. In today's economy, these restraints on competition no longer make sense.
>
> When this new legislation takes effect 90 days from now, retailers will again be able to set prices on a more competitive basis, thereby enabling consumers in all 50 States to shop for the best products at the lowest possible prices.
>
> * * *
>
> I commend the Congress as well for its bipartisan recognition that price competition is important to American consumers and for its timely consideration of this legislation.

Id.

Shortly after the passage of the Consumer Goods Pricing Act in 1975, the Court recognized that Congress endorsed the *per se* rule. In *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the Court affirmed the *per se* prohibition on RPM, stating that "Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions

by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of the individual States." *Sylvania*, 433 U.S. at 52 n. 18 (citations omitted).

3. *Congress Rejected Efforts By The Department Of Justice To Undermine The* Dr. Miles *Rule*

In the early 1980s, the Department of Justice reversed its past course and adopted a position hostile to the *Dr. Miles* rule. The Department first announced its intentions not to enforce the *per se* ban on RPM, and then began to intervene in private antitrust actions on behalf of defendant-manufacturers accused of vertical price fixing. H.R. Rep. No. 237 at 4. When the Department filed an amicus brief on behalf of the defendant in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), Congress reasserted its position with respect to vertical price fixing. Congress passed H.R. 3222, an appropriations measure that cut-off all funds to the Department which would be used "to overturn or alter the *per se* prohibition on resale price maintenance * * *" Pub. L. No. 98-166, 97 Stat. 1071 (1983).

Based on assurances that the Department would not continue its activities in contravention of Congress's support of the *per se* prohibition of vertical price fixing, Congress did not re-enact an appropriations restriction similar to H.R. 3222 for fiscal year 1984. H.R. Rep. No. 237 at 6. When the Department of Justice began circulating a draft of "Vertical Restraints Guidelines," which restated the Department's refusal to enforce the *per se* rule against vertical price fixing, Congress again passed restrictions on appropriations to the Department. Pub. L. No. 99-180, 99 Stat. 1169 (1985). Contrary to the statement in Leegin's brief, the restrictions were also imposed for fiscal years 1987 and 1988 in Public Law 99-500, 100 Stat. 1783-73, § 605 (Oct. 18, 1986) and Public Law 100-202, 101 Stat. 1329-38, § 605 (Dec. 22, 1987).

4. *Congress Continues To Reject Efforts To Undermine The* Dr. Miles *Rule*

Congress has continued to be active in the area of vertical RPM in more recent years as well. In 2002, Congress established the bipartisan Antitrust Modernization Commission. Pub. L. No. 107-273, 116 Stat. 1856 (2002). Congress delegated certain duties to the Commission, including those of examining whether the antitrust laws needed to be modernized, soliciting views from concerned parties on the subject, evaluating proposals for changes, and submitting a final report to Congress and the President. *Id.*

The Commission formed the Single-Firm Conduct Working Group to identify issues the Commission should study with respect to single-firm conduct. In its final recommendations, the Working Group determined that the Commission should not study the *per* se rule against RPM. The Working Group's conclusion was based in part on "Congressional support year in, year out for maintenance of the *per se* rule." Transcript of Meeting of Jan. 13, 2005, at 129-30, *available at* http:// www.amc.gov/pdf/meetings/meetings/50113_Meeting_Transcript_reform.pdf. (emphasis added).

In 1998, the Trademark Anticounterfeiting Act, which would have prohibited the "unauthorized destruction, modification, or alteration of product identification codes," was introduced in Congress. H.R. Rep. 650, 105th Cong., 2nd Sess. at 1, (1998). Proponents of the bill argued it would "safeguard the ability of manufacturers to control the use of their products with which valuable marks are associated * * *" *Id.* at 5.

Recognizing that the bill could have secondary effects on RPM practices, then Representative Charles E. Schumer opposed the bill. He argued that the bill would limit the distribution of branded goods to discount stores or "parallel markets," enable retaliatory action against discounter, and increase consumer prices. Arguing that the true goal of the

bill was to allow manufacturers to have greater control over retail pricing of their goods, Representative Schumer stated:

> The ultimate goal of these manufacturers is to control the final retail price of their products. When done explicitly, this practice known as "resale price maintenance," has been plainly illegal under antitrust laws since 1908. The reason resale price maintenance is illegal is because we want retail outlets to compete on price—that competition yields the best deals for consumers * * *"

Id. at 17. The Trademark Anticounterfeiting Act failed to pass in the House, and has not been reintroduced. H.R. Rep. No. 845, 105th Cong., 2nd Session, at 172--73 (1999). Again, Congress took action to prevent even veiled attempts by manufacturers to achieve RPM, and instead preserved the longstanding *per se* prohibition in order to assure lower prices for consumers.

B. The Court, Congress, Industry, And Consumers All Have Relied On The *Dr. Miles* Rule

Where both Congress and the Court have relied on a precedent to draft laws and decide cases, overruling that precedent has a dramatic effect on settled expectations. *See Sorrell*, 126 S.Ct. at 2490. There is no doubt that the Court consistently has followed and applied the *Dr. Miles* rule in a variety of situations since 1911.[5] There is no doubt that

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[5] *See, e.g., Straus v. Victor Talking Mach. Co.*, 243 U.S. 490 (1917); *Boston Store of Chicago v. American Graphophone Co.*, 246 U.S. 8 (1918); *United States v. A. Schrader's Son, Inc.*, 252 U.S. 85 (1920); *FTC v. Beech Nut Packing Co.*, 257 U.S. 441 (1922); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208 (1939); *Ethyl Gasoline Corp. v. United States*, 309 U.S. 436 (1940); *United States v. Masonite Corp.*, 316 U.S. 265 (1942); *United States v. Bausch & Lomb Optical Co*, 321 U.S. 707 (1944); *United States v. Frankfort Distilleries*, 324 U.S. 293 (1945); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384 (1951); *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960); *White Motor*

Congress endorsed the continued application of the *per se* rule in the Consumer Goods Pricing Act of 1975. The structure of retailing, and its transformation from small retailers to department stores to big-box stores, to category killer speciality stores has evolved in an atmosphere made possible by the *Dr. Miles* prohibition of RPM. Such widespread reliance compels continued adherence to *Dr. Miles*.

Since 1911, *Dr. Miles* has provided a simple, unambiguous, easily followed rule that facilitates competition and reduces consumer prices. *Dr. Miles* is in no way "unworkable" and provides a simple, bright-line limitation on how manufacturers may structure their pricing policies to comport with the antitrust laws and facilitate competition. *See Swift & Co. v. Wickham*, 382 U.S. 111, 124 (1965).

Further, *Dr. Miles*, especially as it has been further explained in *Monsanto Co. v. Spray-Rite Corp.*, 465 U.S. 752 (1964) and *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988), is clear and easily followed by the courts and industry, reducing uncertainty and fostering stability of the law, two major tenets of *stare decisis*. *Swift & Co.*, 382 U.S. at 124; *Itel Containers Int'l Corp. v. Huddleston*, 507 U.S. 60, 79 (1993) (Scalia, J., concurring). The simplicity of *Dr. Miles* has facilitated the complete transformation of the retail sector from one based primarily on small independent stores to the current retailing market featuring large retailers. The "wise policy" when a rule is neither unworkable nor poorly reasoned is to adhere to the rule, because of the importance that the law be stable and predictable. *Payne v. Tennessee*, 501 U.S. 808, 827 (1991).

Co. v. United States, 372 U.S. 253 (1963); *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967); *California Retail Liquor Dealers Ass'n v. Midcal Aluminum*, 445 U.S. 97 (1980); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984); *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987); *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988).

Consumers rely on the ability to comparison-shop between retailers for the best bargain on a certain product, an activity *Dr. Miles* facilitates. Overturning the rule would substantially frustrate the average consumer's ability to shop for a better price or to pick a retailer based upon services offered in conjunction with a particular article.

The passage of the Consumer Goods Pricing Act of 1975, and concurrent re-establishment of the *Dr. Miles* rule against minimum price fixing, has been identified as a "crucial turning point in American retailing." David W. Boyd, *From "Mom and Pop" to Wal-Mart: The Impact of the Consumer Goods Pricing Act of 1975 on the Retail Sector in the United States*, 31 J. Econ. Issues 23 (1997) (hereinafter Boyd). Coincident with the passage of the 1975 Act, the country saw a significant drop in the total number of retail establishments, along with a growth in the sales for each retail store. *Id.* The years since 1975 have seen the development of larger discount retailers offering consumers lower prices. *See Id.* The trend toward discounting can be seen clearly in the Top 100 Retailers list annually published by Stores Magazine, the magazine of the National Retail Federation. The July 2006 report listed Wal-Mart as the top retailer, joined in the top ten by Home Depot, Sears, Costco, Target, Lowe's, and Walgreen—all department or "big-box" stores that specialize in offering customers lower-priced quality items in a convenient setting. Top 100 Retailers, http://www.stores.org/ pdf/06%20 JULY%201-100%20Chart.pdf (last visited Feb. 12, 2007).

Consumers have spoken, and have announced their preference for discount shopping. "Despite everything that we might say about how much we value customer service, look at this list. When push comes to shove, people are going to choose lower prices over service." Margaret Webb Pressler, *Big Box Stores Rate Top-10 List: Wal-Mart's No. 1 Rank Shows U.S. Goes for Price*, WashingtonPost.com, July 11, 2003, http://www.washingtonpost.com/wp-dyn/articles/A419

25-2004Jul11.html. Wendy Liebmann, the founder of consulting firm WSL Strategic Retail, notes that "[d]iscount * * * has become the mantra of today's shopper, regardless of income or education." *Id.*

Consumers rely on their ability to shop at big-box retailers which offer, at lower prices, the same products sold elsewhere. Competing retailers also rely upon their ability to advertise identical goods at lower prices to attract customers. RPM always leads to higher prices for consumers, and eliminates the ability of competing retailers to attract customers by reducing prices. Overturning the rule of *Dr. Miles* would take away the ability of the average consumer to comparison shop for goods, and would dramatically upset the average consumer's lifestyle.[6]

C. The Court Has Indicated That Any Change To The *Dr. Miles* Rule Be Made By Congress

On repeated occasions, the Court has indicated that Congress should set antitrust policy regarding RPM if Congress does not agree with the *Dr. Miles* rule. Shortly after the rule was adopted, Justice Brandeis found that the *Dr. Miles* rule had become "settled law" and stated: "If the rule so declared is believed to be harmful in its operation, the remedy may be found, as it has been sought, through application to the Congress * * *." *Boston Store of Chicago v. American Graphophone Co.*, 246 U.S. 8, 28 (1918) (Brandeis, J., concurring). Notwithstanding this clear invitation, Congress did not change the *Dr. Miles* rule.

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[6] Leegin has suggested that up to ten percent of all retail products might be subject to RPM if legalized. *See* Petitioner's Brief, n. 12. Given that RPM may increase the price of goods by as much as 18-27% (*see* S. Rep. No. 466, Congress 1st Sess. (1975)), the price shock proposed by Leegin's position is nothing short of enormous.

Concurring in *Monsanto*, Justice Brennan observed that:

> [*Dr. Miles*] has stood for 73 years, and Congress has certainly been aware of its existence throughout that time. Yet Congress has never enacted legislation to overrule the interpretation of the Sherman Act adopted in that case. Under these circumstances, I see no reason for us to depart from our longstanding interpretation of the Act.

465 U.S. at 769 (Brennan, J., concurring)

In reaction to the McGuire Act, the Court observed "Whether it is good policy to permit [state laws sanctioning RPM schemes] is a matter for Congress to decide." *Hudson Distrib., Inc., v. Eli Lilly & Co.*, 377 U.S. 386, 395 (1964). There is no reason to depart from the Court's long-standing and consistent conclusions that should change in this area be needed, it must be sought from Congress. Congress is the appropriate policy making body to address *Dr. Miles* and its progeny:

> the orderly way to eliminate error * * *, if any there be, is by legislation and not by court decision. Congressional processes are more accommodative, affording the whole industry hearings and an opportunity to assist in the formation of new legislation. The resulting product is therefore more likely to protect the industry and the public alike.

Radovich, 352 U.S. at 452.

Antitrust policy is an area of special federal power wielded by Congress, "and it certainly is not for [the Courts] to indulge in the business of policy-making in the field of antitrust legislation." *Jefferson County Pharm. Ass'n, Inc. v. Abbott Labs.*, 460 U.S. 150, 170 (1983) (quoting *United States. v. Cooper Corp.*, 312 U.S. 600, 606 (1941)). Indeed, antitrust analysis involves many broad policy determinations that courts are not equipped to address, and that are best

reserved for Congress. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344–45 (1977); *United States v. Pabst Brewing Co.*, 384 U.S. 546, 552 (1966).

For the doctrine of *stare decisis* to retain its "fundamental importance to the rule of law," the Court must follow it. *Hilton v. South Carolina Pub. Rys. Comm'n*, 502 U.S. 197, 202 (1991). Because *stare decisis* is a central tenet of the Court's jurisprudence, a decision to overrule 100 years of precedent cannot be taken lightly. *See Payne v. Tennessee*, 501 U.S. at 842 (Scalia, J., concurring) ("overruling a precedent of this Court is a matter of no small import."). Indeed, "a doctrine of *stare decisis* that is suspended when five Justices find it inconvenient * * * is no doctrine at all, but simply an excuse for adhering to cases we like and abandoning those we do not." *Hohn v. United States*, 524 U.S. 236, 263 (1998) (Scalia, J., dissenting).

II. THERE IS NO DEMONSTRABLE ECONOMIC EVIDENCE THAT OVERTURNING OR ALTERING *DR. MILES* WOULD PROMOTE EFFICIENCY

A. The *Per Se* Rule Promotes The Fundamental Antitrust Policy Of Lowering Prices

A fundamental principle of antitrust law and policy—repeatedly endorsed by Congress and the courts –resolves the case: "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. * * * We have adhered to this principle regardless of the type of antitrust claim involved." *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. at 340. The Court recently reiterated this principle in the context of a predatory bidding claim in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, No. 05-381 slip op. (U.S. Feb. 20, 2007). In *Weyerhaeuser*, the Court again recognized that "discouraging a price cut and * * * depriving

consumers of the benefits of lower prices * * * does not constitute sound antitrust policy." slip op. at 6 (quoting, *Brook Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993)).

Price competition is the driving force in a market economy. "Price is the 'central nervous system of the economy.'" *Nat'l Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679, 692 (1978) (quoting *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 226 n.59 (1940)). "Cutting prices in order to increase business often is the very essence of competition." *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 594. When it comes to conduct that lowers prices, "mistaken inferences * * * chill the very conduct the antitrust laws are designed to protect." *Id. See also, Weyerhaeuser*, slip op. at 7-8. A legal rule that inhibits price cutting "risks interference with one of the Sherman Act's most basic objectives: the low price levels that one would find in well-functioning competitive markets." *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 231 (1st Cir. 1983) (Breyer, J.).

Thus, RPM acts on the central nervous system of the economy in a direct way that other vertical restrictions simply cannot. As noted in *Sylvania* and as Justice Brennan observed in *White Motor Co. v. United States*, "resale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands." 372 U.S. at 260. By its very nature, RPM eliminates price competition among sellers of a single brand, and prevents those sellers from reducing prices to meet price reductions in competing products, or to challenge competing products by lowering prices. The price competition—both intrabrand and interbrand—that is central to the operation of the marketplace is disrupted.

The theoretical possibility that foreclosing price competition will open some other competitive path is a weak,

hypothetical, speculative, and unproven basis for undermining the foundation of antitrust law. No empirical study ever has shown that consumers tangibly benefit by the imposition of RPM, and Leegin points to none.

In stark contrast, empirical studies show that RPM increases price to consumers.[7] This effect alone justifies the *Dr. Miles* rule. Any conduct that is designed to, and which has been proven in action to, raise consumer prices is antithetical to the Sherman Act. That fact justifies treating price restrictions different than nonprice restrictions. Although nonprice restrictions may affect resale prices, the effect is not as direct and certain.

Collective experience includes many instances when the elimination of RPM has led to significant savings for consumers. For example, brand name soft white light bulb prices fell more than thirty percent between 1980 and 2002, following the elimination of RPM and other vertical restrictions; experience in the United Kingdom, France and Sweden showed that RPM impeded the growth of low-cost, low margin distributors; the elimination of RPM is associated with a decline in margins by drug stores—margins have dropped from the traditional 40% level to 20%; and ending Levi Strauss's RPM in 1976 resulted in annual gain in consumer surplus exceeding $200 million for men's jeans alone. F.M. Sherer, *Comment on Cooper et al.'s "Vertical Restric-*

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[7] Overstreet summarized the empirical evidence: "The price surveys indicate that RPM in most cases increased the prices of products sold with RPM, although this was not always the case." Thomas R. Overstreet, Jr. *Resale Price Maintenance: Economic Theories and Empirical Evidence*, Bureau of Economics Staff Report to the Federal Trade Commission, p. 160 (1983). Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. Pol. Econ. 1074, 1078 (1986), concluded: "In summary, the limited price information on the effects of RPM suggests that the practice exerted substantial upward pressure on retail prices."

tions and Policy," Competition Pol'y Int'l, Autumn 2005, at 65, *available at* http://www.esapience.org/render_cms_image.aspx?itemId=611&detailID=151.

B. No Empirical Study Ever Has Shown, Nor Likely Ever Will, That Resale Price Maintenance Enhances Competition

Notwithstanding years of study, no economist has ever proven that consumers of a product sold subject to RPM benefitted from paying higher prices. Instead, economists have hypothesized possible explanations for manufacturers' desire to fix minimum retail prices. The explanations have varied from the inapplicable notion of "free-riding,"[8] to the dubius notion of "quality certification,"[9] to the notion that RPM may encourage retailers to maintain greater inventory levels. What is missing from this speculation is any evidence that consumers benefit tangibly from higher prices.

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[8] Phillip Areeda & Herbert Hovencamp, 8 Antitrust Law (2d Ed. 2004) ¶ 1611f (hereinafter Areeda's Hovencamp): "Free riding is, of course, impossible in the absence of significant dealer services that can be freely utilized by consumers who then buy elsewhere." In the case of goods such as those at issue, "services" such as nice displays and knowledgeable, friendly staff are simply not subject to free-riding. See Mathewson & Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Ind. Ord. 57 at 68 (1998). "[W]ith regard to the famous Chicago free-rider, presale services explanation, one could claim that such services have been identified in nine of every five markets in which they actually matter." Howard P. Marvel, *Distribution Matters*, XLIX Antitrust Bulletin 953, 960 (2004).

[9] Areeda & Hovencamp, *supra*, note 8, ¶ 1613g: "As a justification for resale price maintenance, the fashion or quality certification arguments seem relatively weak." Quality certification requires that a manufacturer market to a prestigious retailer, and that other dealers trade upon that prestige. Leegin has chosen not to market to identifiable prestigious dealers, but instead to sell to small retailers, such as Kay's Kloset. Under these circumstances, each dealer is trading on its own prestige, and not relying upon someone else's "quality certification."

Unlike vertical nonprice restraints aimed at insuring efficient levels of services, vertical price restraints are at best blunt instruments. Retailers are guaranteed a super-competitive margin, and a manufacturer supposedly hopes that competitive pressures cause retailers to consume that margin engaging in nonprice competition. In this case, Kay's Kloset served its customers with friendly, well-trained staff in attractive surroundings, stocked a full inventory of Brighton products, and actively promoted the Brighton brand. It did not "free ride" on similar services other retailers provided. It provided services and charged less simply because it was more efficient in doing so. Because of Leegin's illegal pricing agreements, Kay's Kloset was not permitted to pass the benefit of its efficiency on to consumers.

C. RPM Has Negative Effects On Competition, Innovation, And Efficiency

Economists recognize that RPM can interfere with competition in a number of ways. These include the ability of such restrictions to facilitate cartelizing a market, *see Continental T.V., Inc. v. GTE Sylvania*, 433 U.S. at 51 n.18, which may well have been Leegin's goal in this case. Leegin's activities in coordinating its pricing practices with its dealers, as well as acting to mediate disputes among competing retailers, show a retail cartel in operation.

The inability to meaningfully distinguish between cartels formed by retailers and restrictions imposed by manufacturers was a problem confronted in *Dr. Miles* and it continues today. In *Dr. Miles*, the Court held that a manufacturer who imposes a vertical price fixing agreement: "can fare no better with its plan of identical contracts than could the dealers themselves if they formed a combination and endeavored to establish the same restrictions, and achieve the same results, by agreement with each other." 220 U.S. at 408. See also, *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 744 n.7 (Stevens, J., dissenting) (*Dr. Miles*, made RPM *per se* illegal because

RPM plans "are thereby similar to plans pursuant to which the dealers themselves conspire to fix prices.").

Given the close working relationships that may exist between a manufacturer and its retailers, the possibility that the manufacturer's policies reflect the retailers' desire to avoid competition may well be the reason for most RPM programs. "[W]e doubt that dealer power is that rare and are troubled by an apparent history of price-enhancing resale price maintenance for the benefit of dealers. At least some of the claimed justifications for it actually reflect dealer power, and antitrust rules controlling horizontal combinations cannot prevent these distribution restraints that result from dealer power." Areeda & Hovencamp, at ¶ 1604.

The elimination of intrabrand competition often leads to a number of problems. First, increased efficiency available from price flexibility is eliminated. For example, Leegin's national system of price controls prevented prices from reflecting local conditions or temporal changes in demand. *See* Areeda & Hovencamp, at ¶1631a5 (noting that price stability "is hardly a worthy object for antitrust law. Although price instability and confusion may occasionally impose costs on society, price stabilization remains generally pernicious."). A single nationwide price cap, especially when applied to geographically dispersed dealers with no direct competitors, results in many dealers receiving and retaining excess profits with no incentive to provide any further services.

Second, RPM has been associated with the preservation of outmoded means of distribution. The existence of a guaranteed margin provides retailers with little incentive for innovation in their retail practices. Robert L. Steiner, *The Evolution and Applications of Dual-Stage Thinking*, XLIX The Antitrust Bull. 877, 899 (2004) ("The greatest social welfare loss from (voluntary) vertical restraints * * * has arisen from * * * vertical price restraints that have historically

retarded the growth of a series of new and more efficient forms of retailing * * *.").

Third, manufacturers are shielded from competitive pressure that could arise from vigorous competition among the retailers of the manufacturers' products. If a manufacturer cannot guarantee a retail margin, a manufacturer may have to engage in price competition with other manufacturers to attract retailers for its product. Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1492 (1983).

Fourth, providing a guarantee on sales of one brand margin to a retailer can induce the retailer to pressure consumers to move from other products that better fit consumers' needs to the favored brand. Such behavior is not the result of an efficient market. Areeda & Hovencamp, *supra*, at ¶1601n. RPM encourages dealers to engage in a variety of promotional practices that lead to consumer injury. Warren S. Grimes, *Spiff, Polish, and Consumer Demand Quality: Vertical Price Restrictions Revisited*. 80 Cal. L. Rev.815, 837-38 (1992) (hereinafter Grimes).

Fifth, to the extent that RPM leads to a competitive increase in retailer services, some customers will receive unnecessary and unwanted services, making them worse off because they are forced to pay for such services. William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 999 (1985). Given the clear preference for discount stores, it is axiomatic that most customers prefer stores offering lower prices over those offering greater services.

There are limits to the extent to which economic theory can supply a rule of law. Thus, antitrust laws:

> cannot precisely replicate the economists' (sometimes conflicting) views. For, unlike economics, law is an administrative system the effects of which depend upon

> the content of rules and precedents only as they are applied by judges and juries in courts and by lawyers advising their clients. Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve. Thus, despite the theoretical possibility of finding instances in which horizontal price fixing, or vertical price fixing, are economically justified, the courts have held them unlawful per se, concluding that the administrative virtues of simplicity outweigh the occasional "economic" loss.

Barry Wright, 724 F.2d at 234 (Breyer, J.).

This reality makes adherence to the *per se* rule appropriate here:

> These conclusions suggest the wisdom of the *Dr. Miles* line of cases that culminated in a per se prohibition of vertical price fixing. The complexities of sorting out procompetitive, benign, and anticompetitive dealer brand promotion (and the difficulty in monitoring dealer conduct) weigh against a rule-of-reason approach to vertical price restraints. Courts are ill-equipped to carry out such open-ended balancing tasks involving potentially limitless economic data and conflicting expert testimony. A simple rule proscribing minimum resale price maintenance is more easily understood and enforced.

Grimes, 80 Cal. L. Rev. 815 (1992).

To the extent some economists have hypothesized that RPM may have some theoretical benefits, economic analysis lacks the tools and sophistication to identify those benefits' presence in a particular situation or to assess whether they offset the attendant adverse effects. The failing is even greater in a market characterized by a high degree of product differentiation.

The obvious and inevitable impact of resale price maintenance—recognized by everyone—is that consumers pay

more. Under these circumstances, the permissibility of vertical price fixing must be guided in large part by past experience and common sense, fundamentally pragmatic policy factors, precisely the considerations upon which the *per se* rule of *Dr. Miles* relies. Indeed, it is imperative to safeguard practices that result in lower consumer prices, since "cutting prices to increase business often is the very essence of competition." *State Oil Co. v. Khan*, 522 U.S.at 15.

III. LEEGIN'S RETAIL PRICE FIXING VIOLATED PROHIBITIONS AGAINST HORIZONTAL CARTELS

Leegin did not participate in the market solely as an upline distributor. It was a dealer of its products at the retail level as well. This fact distinguishes this case from *Dr. Miles*. In *Dr. Miles*, the manufacturer defendant was not also an active participant in the retail market implementing a horizontal cartel. No one questions the pernicious effect of retail competitors conspiring to fix prices. That conduct is the archetypal example of actions that are presumed illegal without further examination. *Catalono, Inc. v. Target Sales, Inc.*, 446 U.S. 643, 646-47 (1980). Even Leegin concedes that such horizontal agreements among retailers are anticompetitive. *See* Petition, p. 16.

Contracts between competitors are not saved from the *per se* rule of illegality because one of the competitors distributes to the other. In *United States v. McKesson & Robbins*, 351 U.S. 312 (1955), the Court analyzed a dual-distribution system. In that case, a manufacturer who distributed directly to retailers, as well as to wholesalers, entered into agreements with both retailers and other wholesalers to fix the resale price of its goods. Although the agreements with retailers were saved by the Miller-Tydings and McGuire Act exemptions then in effect, the agreements with other wholesalers were illegal *per se*. The Court noted that those acts "expressly continue[d] the prohibitions of the Sherman Act

against 'horizontal' price fixing by those in competition with each other at the same functional level." *Id.* at 313 (quoting *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 389 (1951)). Because the defendant in *McKesson* participated in the wholesale market, its contracts with other wholesalers violated the "*per se* rule of illegality [for] resale price maintenance contracts between firms competing on the same functional level." *Id.* at 315.

Leegin cannot have it both ways. It cannot maintain that vertical price fixing arrangements are benign, while horizontal arrangements are not, and yet maintain that it can both fix prices among retailers and participate in a significant economic manner in the retail market. Such an arrangement violates traditional prohibitions against price fixing among competitors.

The power of Leegin "to fix the price of the product that it manufactures, and which the entire group sells and with respect to which all have been and are now actual or potential competitors, is a powerful inducement to abandon competition." *United States v. Masonite Corp.*, 316 U.S. 265, 281 (1942). Price fixing among competitors of a single brand falls within the long-standing prohibition against horizontal cartels. *See United States v. Sealy*, 388 U.S. 350, 356 n.3 (1967). It does not matter whether the prices or pricing practices were discussed and voted on by the entire group: "The fixing of prices by one member of a group pursuant to express delegation, acquiescence, or understanding is just as illegal as the fixing of prices by direct, joint action." *Masonite Corp.*, 316 U.S. at 276. The negative impact on consumers—who pay higher prices—is the same no matter how a cartel is achieved.

Thus, this case implicates the long-standing prohibitions on both vertical price fixing and horizontal cartels. Permitting Leegin to fix retail prices to benefit its own combined

wholesale/retail operation violates the Sherman Act's fundamental prohibition against cartels.

The record below contains compelling evidence of a horizontal cartel designed and intended to benefit Leegin's retail operations. As a result, even were Leegin's conduct not prohibited by the *per re* rule against vertical price fixing, the jury was properly instructed that Leegin's conduct was a *per se* violation of the Sherman Act's bedrock prohibition on horizontal cartels. On this basis alone, the verdict below should be affirmed.

CONCLUSION

For the foregoing reasons, the Court should affirm the decision below.

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February 26, 2007

Supreme Court, U.S.
FILED
MAR 16 2007
OFFICE OF THE CLERK

(27)

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., doing business as Kay's Kloset . . .
Kay's Shoes,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit

REPLY BRIEF FOR PETITIONER

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RULE 29.6 STATEMENT

The corporate disclosure statement included in the petition for a writ of certiorari remains accurate.

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REPLY BRIEF FOR PETITIONER

Nothing in PSKS's brief diminishes the stark contrast between *Dr. Miles*' antiquated *per se* rule against resale price maintenance and this Court's modern antitrust jurisprudence, which recognizes that *per se* treatment is appropriate only when "experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997). PSKS never comes to terms with this Court's approach to vertical distribution agreements—particularly the Court's recognition that *per se* analysis is ill-suited to vertical restrictions "because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 (1977). PSKS instead proposes novel standards for evaluating such arrangements, including its remarkable assertion that "[a]ny conduct that is designed to . . . raise consumer prices is antithetical to the Sherman Act" and should therefore be *per se* unlawful. Resp. Br. 23. This Court has never endorsed the positions that PSKS urges. Indeed, adopting PSKS's arguments would require the Court to abandon several of the core principles underlying modern vertical restraints cases, an approach that is foreclosed by this Court's recognition that "rules in this area should be formulated with a view towards protecting the doctrine of *GTE Sylvania*." *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 726 (1988).

I. PSKS IGNORES THE CORE PRINCIPLES OF *SYLVANIA*, *SHARP*, AND *KHAN*.

A. Over the past thirty years, this Court has repeatedly held that *per se* rules are appropriate only for "conduct that would always or almost always tend to restrict competition and decrease output." *Sharp*, 485 U.S. at 723 (internal quotation marks omitted); *see also Sylvania*, 433 U.S. at 49-50;

Khan, 522 U.S. at 10; *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 19-20 (1979). The Court has explained that "the 'rule of reason' [is] the prevailing standard of analysis," *Sylvania*, 433 U.S. at 49, and that a "departure from the rule-of-reason standard must be based upon demonstrable economic effect," *id.* at 58-59. PSKS does not even attempt to meet that standard. Nor could it. As discussed below, economists and legal scholars have overwhelmingly concluded that resale price maintenance can be used for procompetitive purposes and that there are many situations in which the practice is unlikely to lead to anti-competitive effects.

Instead of attempting to meet the Court's requirement for *per se* illegality that resale price maintenance be almost invariably anticompetitive, PSKS argues that the practice "may" have anticompetitive effects in some circumstances and that Leegin has not come forward with enough "empirical" proof of procompetitive effects to justify rule-of-reason treatment. Resp. Br. 6, 23. But that speculation does not begin to support retaining a *per se* rule. In its decisions overturning *per se* rules, this Court has not required "empirical" proof of procompetitive effects or proof that a practice is *always* procompetitive. Instead, the Court has focused on considerations such as whether "there is substantial scholarly and judicial authority supporting [the] economic utility" of a practice. *Sylvania*, 433 U.S. at 57-58; *see also id.* at 54-55 ("Economists have identified a number of ways in which manufacturers can use such restrictions to compete more effectively against other manufacturers."); *Khan*, 522 U.S. at 15 (relying on "a considerable body of scholarship discussing the effects of vertical restraints"). Those same considerations require overturning the rule of *Dr. Miles*.

PSKS further argues, without citation, that "economic analysis lacks the tools and sophistication to identify" the benefits of resale price maintenance "in a particular situation or to assess whether they offset the attendant adverse ef-

fects." Resp. Br. 28. The lower courts' experience applying the rule of reason to vertical nonprice agreements since *Sylvania* casts serious doubt on this proposition. *See* Pet. Br. 36-39. But even if PSKS were correct, that would not be a justification for retaining a *per se* rule. If it is unclear in a particular situation whether a vertical restraint has net procompetitive or anticompetitive effects, a *per se* rule cannot apply. In fact, a *per se* rule is appropriate *only* where the economic impact of the challenged practice is "immediately obvious." *FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 458-59 (1986); *see also Nat'l Soc'y of Prof. Eng'rs v. United States*, 435 U.S. 679, 692 (1978). Resale price maintenance does not satisfy this condition.

B. PSKS is mistaken in asserting that "the primary antitrust policy objective" is "lowering prices for consumers." Resp. Br. 5. This Court stated otherwise in *Sylvania*, where it made clear that "[i]nterbrand competition . . . is the primary concern of antitrust law." 433 U.S. at 52 n.19; *see also Khan*, 522 U.S. at 15 ("Our analysis is . . . guided by our general view that the primary purpose of the antitrust laws is to protect *inter*brand competition." (emphasis added)); *Sharp*, 485 U.S. at 726 (same). Based on its erroneous view of the "primary antitrust policy objective," PSKS argues that "[a]ny conduct that is designed to, and which has been proven in action to, raise consumer prices is antithetical to the Sherman Act." Resp. Br. 23. PSKS cites no authority for this proposition, which this Court has never adopted.[1]

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[1] The *amici* States also argue that "higher prices are themselves" an anticompetitive effect (States Br. 6), but the States took precisely the opposite approach in *Khan*, arguing that "[c]onsumers in some cases may be better served by retailers that charge higher prices" because "higher prices may be preferred where better service is bundled with the product." Br. of *Amici* States at 14-15 & n.14, *Khan* (No. 96-871). The only consistency is that the *amici* States prefer *per se* rules because they are relieved of the need to meet their burden to prove anticompetitive effects.

There are, of course, other dimensions to competition than retail prices. Indeed, there are numerous actions that can raise consumer prices while enhancing competition and consumer welfare. For example, manufacturers that advertise their products or upgrade product qualities incur costs that are passed through to consumers in the form of higher prices, yet there is no reason to believe these actions are uniformly "antithetical to the Sherman Act." Indeed, this Court specifically recognized in *Sharp* that vertical distribution restraints can raise retail prices while also fostering interbrand competition and enhancing consumer welfare:

> [A]ll vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase "prices" and can be characterized as intended to achieve just that. In fact, vertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services.

485 U.S. at 728. Accordingly, even though *Sharp* involved "an agreement between a manufacturer and a dealer to terminate a 'price cutter'" that was designed to affect prices, the Court held that the conduct should be evaluated under the rule of reason because it had the potential to enhance interbrand competition. *Id.* at 725-26. Clearly, a vertical distribution restraint cannot be condemned merely because it raises consumer prices. The critical question is the effect of the arrangement on overall interbrand competition.[2]

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[2] PSKS is also incorrect in arguing that resale price maintenance invariably leads to higher retail prices. *See* Pet. Br. 17 n.7. The pricing studies on which PSKS relies have been criticized as being "very misleading as to the effects of changes in the legal status of RPM." Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. Pol. Econ. 1074, 1094 (1986). Moreover, none of the

C. PSKS and its *amici* similarly disregard the principles underlying *Sylvania* and *Sharp* by focusing solely on the reduction of intrabrand competition resulting from resale price maintenance agreements, while ignoring any countervailing positive effects on interbrand competition. *See, e.g.*, Resp. Br. 6 ("The only uniform and demonstrable effect of RPM is higher consumer prices."); States Br. 6. Contrary to PSKS's approach, this Court explained in *Sylvania* that "[t]he market impact of vertical restrictions is complex because of their potential for a simultaneous reduction of intrabrand competition and stimulation of interbrand competition." 433 U.S. at 51; *see also id.* at 54-55 ("Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products."). In light of this complexity of impact and the potential for countervailing impacts on intra- and interbrand competition, the Court concluded that the vertical restraints at issue should be evaluated under the rule of reason. *Id.* at 58.

PSKS fails to address the well-recognized positive effects on interbrand competition that can motivate manufacturers to implement vertical arrangements. In particular, PSKS never explains why a manufacturer might take actions that expand its retailers' margins, unless it expects to achieve some benefit in the promotion of its product against its interbrand rivals. Clearly, manufacturers have no interest in enriching their retailers if there are no such countervailing benefits. *See, e.g., Sylvania*, 433 U.S. at 56 ("manufacturers have an economic interest in maintaining as much intrabrand competition as is consistent with the efficient distribution of their products"); Br. of Economists 5. The benefits to inter-

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[Footnote continued from previous page]

pricing studies cited by PSKS measures the level of services provided in connection with price-maintained products, the impact of resale price maintenance on demand for those products, or the entry-enhancing properties of using resale price maintenance.

brand competition that prompt manufacturers to institute vertical nonprice agreements—which this Court identified in *Sylvania* and *Sharp* as supporting rule-of-reason treatment—are the same benefits that motivate manufacturers to institute resale price maintenance arrangements. *Sylvania* and *Sharp* foreclose PSKS's attempt to disregard these benefits by focusing solely on the effects of resale price maintenance on the price component of intrabrand competition.

II. THERE IS A CONSENSUS AMONG ECONOMISTS THAT RESALE PRICE MAINTENANCE CAN HAVE SUBSTANTIAL PROCOMPETITIVE EFFECTS.

It is beyond serious debate in the economic community that resale price maintenance can have positive effects on interbrand competition and can yield substantial benefits for consumers. The Court need look no further than the *amicus curiae* brief submitted by 23 of the Nation's leading antitrust economists. The *amici* economists explain that "the incentives facing retailers may be out of alignment with those of manufacturers, to the detriment of the manufacturers' ability to compete effectively with the products of competing manufacturers," and they describe how "RPM can help to align these incentives and enhance the competitiveness of a manufacturer's product, thereby benefiting consumers." Br. of Economists 5-11. The economists explain that "even where minimum RPM raises the price charged by a given retailer, that does not mean that there is necessarily an anticompetitive effect." *Id.* at 12.

The *amici* economists further point out that "it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects." *Id.* at 16. While there is a disagreement in the literature with respect to the relative frequency with which resale price maintenance can have procompetitive or anticompetitive effects, "[t]he posi-

tion absent from the literature is that minimum RPM is most often, much less almost invariably, anticompetitive. Thus, the economics literature provides *no* support for the application of a *per se* rule." *Id.* (emphasis added). The views of the *amici* economists are consistent with the economic and legal literature, which is replete with articles and texts that describe the procompetitive effects of resale price maintenance and recommend rule-of-reason treatment. *See* Pet. Br. 13 n.4; Br. of CTIA—The Wireless Association 7-8.

Neither PSKS nor its *amici* cites a single article or economic commentary that expresses doubt about the existence of procompetitive uses of resale price maintenance. Indeed, even the commentators who express the greatest concern about potential anticompetitive uses of resale price maintenance acknowledge that the practice can be used for procompetitive purposes in a number of situations.[3]

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[3] *See, e.g.*, Robert L. Steiner, *The Evolution and Applications of Dual-Stage Thinking*, 49 Antitrust Bull. 877, 899 (2004) (arguing that "antitrust intervention against firms that have adopted vertical price or distribution restraints must be confined to brands that enjoy a very strong consumer franchise"); William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 1001-02 (1985) ("[I]n the case of new products or products of new entrants into the market, vertical restraints . . . should be permissible, or at least should be treated more leniently in [a] . . . rule of reason analysis."); *Interview with FTC Commissioner Pamela Jones Harbour*, The Antitrust Source, Mar. 2006, at 3, *at* http://www.ftc.gov/speeches/harbour/060215HarbourIntrvwC.pdf ("We know that vertical restraints may be procompetitive or anticompetitive, and this depends on numerous factors. It also depends on a complex analysis of interrelationships and incentives among various distribution channel participants."); Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1495 (1983) (suggesting that there should be "exceptions to a *per se* rule" or a "'characterization' step" in which a court determines whether to apply the rule of reason or a *per se* rule based on the circumstances of a given case).

Faced with this mountain of scholarship, PSKS and its *amici* label the economic literature "speculation" and argue that there is not enough "real-world evidence" or "empirical support for the belief that minimum RPM has procompetitive effects." Resp. Br. 24; States Br. 11. The economic community, however, does not share PSKS's skepticism toward the procompetitive potential of resale price maintenance. Br. of Economists 4-11. Nor did this Court insist on the empirical evidence that PSKS demands when it considered the effects of vertical territorial restraints in *Sylvania*.[4]

Moreover, there are, in fact, empirical analyses that support the conclusion that manufacturers can and do use resale price maintenance for procompetitive purposes.[5] Similarly, there are a number of "real world" case studies that describe the procompetitive uses of resale price maintenance and the anticompetitive effects of the government's efforts to prosecute the practice.[6] In addition, the *amicus curiae* brief submitted by PING, Inc., provides a striking illustration of the potential procompetitive effects of resale price maintenance

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[4] *Cf.* Pet. Br. at 26, *Sylvania* (No. 76-15) (criticizing as "speculative" the argument that the elimination of intrabrand competition can stimulate interbrand competition, and arguing that "it is impossible to tell whether conceded elimination of intrabrand competition in fact has off-setting pro-competitive interbrand effects").

[5] *See, e.g.*, Thomas R. Overstreet, Jr., Bureau of Econ., FTC, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 163 (1983) (economic theory "suggests that RPM can have diverse effects, and the empirical evidence suggests that, in fact, RPM has been used . . . in both socially desirable and undesirable ways"); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 292 (1991).

[6] *See, e.g.*, Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J.L. & Econ. 285 (1996); Overstreet, *supra*, at 119-29 (summarizing a number of case studies).

and the substantial anticompetitive effects of continued *per se* condemnation of the practice.[7]

There would likely be even more empirical studies analyzing the procompetitive effects of resale price maintenance, but "real world" examples are difficult to identify because the practice has been subject to an inflexible *per se* prohibition throughout the period in which modern economic analysis of the practice has developed. For example, in this case Leegin attempted to introduce "real world" evidence of the procompetitive purposes and effects of its use of resale price maintenance, including the report of Professor Kenneth Elzinga, but PSKS successfully sought the exclusion of such evidence. Moreover, even if there were a genuine dispute about whether resale price maintenance can have procompetitive effects or the frequency or strength of such effects, that is not a reason to retain a rule that presumes the practice to be anticompetitive without any examination of its actual effect. *See Sharp*, 485 U.S. at 723 ("*per se* rules are appropriate only for conduct that is manifestly anticompetitive").

III. THE OTHER ARGUMENTS ADVANCED BY PSKS DO NOT SUPPORT RETAINING THE *PER SE* RULE OF *DR. MILES*.

Failing to offer a demonstrable economic effect that supports a *per se* rule condemning all uses of resale price maintenance, PSKS offers a handful of alternative arguments for retaining the *per se* rule of *Dr. Miles*. Each of those arguments falls short.

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[7] PING describes how enforcing minimum resale prices allows it to provide unique products in the competitive marketplace for golf equipment that enhance consumer choice and interbrand competition. *See* PING Br. 9. PING further describes how the rule of *Dr. Miles* has forced it to implement an elaborate, costly, and inefficient program—all to comply with the *Colgate* doctrine and thereby avoid the rigid *per se* rule. *Id.* at 10-11. These costs could be avoided, to the benefit of consumers, if resale price maintenance were evaluated under the rule of reason. *Id.*

A. *Stare Decisis* And Supposed Congressional Acquiescence Do Not Support Retaining The Outdated Rule Of *Dr. Miles*.

1. PSKS asserts that "traditional *stare decisis* principles compel retaining" the rule of *Dr. Miles*. Resp. Br. 7-10. PSKS, however, omits any mention of either the Court's treatment of this issue in *Khan*, in which the Court rejected the same argument that PSKS now raises, or the long line of cases in which this Court has emphasized the dynamic nature of the Sherman Act and the role of the Court in adapting that law to "the lessons of accumulated experience." *Khan*, 522 U.S. at 20; *see also* Pet. Br. 32-33.

The Court has repeatedly recognized that "the term 'restraint of trade,' as used in § 1, . . . 'invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890.'" *Khan*, 522 U.S. at 21. "The changing content of the term 'restraint of trade' was well recognized at the time the Sherman Act was enacted." *Sharp*, 485 U.S. at 731.

This Court has never left an outmoded *per se* rule in place based on considerations of *stare decisis*.[8] Indeed, the Court expressly rejected *stare decisis* as a basis to retain the *per se* rules in *Sylvania* and *Khan*. *See Sylvania*, 433 U.S. at 58 n.30; *Khan*, 522 U.S. at 20-21. As the Court explained in *Sharp*, "[i]t would make no sense to create out of the single term 'restraint of trade' a chronologically schizoid statute, in which a 'rule of reason' evolves with new circumstances and

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[8] Likewise, the Court has never altered the standard for assessing the propriety of a *per se* rule because the rule had already been in place. For example, in *Sylvania* and *Khan*, the Court assessed the *per se* rules under the same standard that the Court had set forth in numerous prior opinions. *See supra* at 1-2. Notably, in *Khan*, the Court rejected the argument of the *amici* States that principles of *stare decisis* required the petitioner to carry a "heavy burden of adducing compelling legal or societal reasons for overturning *Albrecht*." Br. of *Amici* States at 20, *Khan* (No. 96-871).

new wisdom, but a line of *per se* illegality remains forever fixed where it was." 485 U.S. at 732.[9]

2. PSKS insists that Congress has given a "clear endorsement of the *per se* rule against RPM" (Resp. Br. 8), and that Congress has "expressly declared its intent to return to the *Dr. Miles* standard" (*id.* at 12). PSKS cannot, however, point to any legislation that mandates—or "expressly declared"—that a *per se* rule be applied to resale price maintenance. Contrary to PSKS's unsupported assertions, Congress has never passed such legislation.[10]

Congress's repeal of the Miller-Tydings and McGuire Acts does not require that resale price maintenance be treated as *per se* unlawful. The Miller-Tydings and McGuire Acts permitted complete antitrust exemptions for resale price maintenance where it was permitted under state law. Congressional repeal of that exemption manifested disagreement with *per se* legality, not rule-of-reason treatment. "Con-

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[9] The Court's common-law role in interpreting the phrase "restraint of trade" does not mean that considerations of *stare decisis* have no place at all in interpreting the Sherman Act. For example, PSKS and its *amici* cite cases in which the Court held that *stare decisis* is an important consideration in assessing issues such as antitrust exemptions for certain industries or limitations on the type of remedies that may be sought by particular types of plaintiffs. *See* Resp. Br. 9-10; AAI Br. 5-6. Significantly, however, none of those decisions involved a broadly applicable interpretation of the phrase "restraint of trade." The cases relied upon by PSKS and its *amici* are thus easily distinguished from the present case. *See Khan*, 522 U.S. at 19 (rejecting the respondents' reliance on the baseball exemption cases "because those decisions are clearly inapposite").

[10] PSKS is also incorrect in asserting that the Court has had "numerous opportunities to examine the continuing appropriateness of the" rule of *Dr. Miles*. Resp. Br. 7. To the contrary, the Court did not consider the viability of the rule in *Sylvania*, *Sharp*, *Monsanto*, *Khan*, or any other recent case. To the extent the Court referred to the rule of *Dr. Miles* in any of those cases, it was simply describing the state of the law, not making an advisory ruling that the rule should be preserved in perpetuity.

gress's action in repealing an antitrust immunity for resale price maintenance was not the same thing as outlawing the practice." Richard A. Posner, *Antitrust Law* 189 (2d ed. 2001); *see also* Pet. Br. 34-35. Congress has never legislated on the question whether resale price maintenance should be evaluated under the rule of reason. Nor should it be expected to have done so. It has long been recognized as "unmistakably clear" that Congress's intent in passing the Sherman Act was "to allow courts to develop governing principles of law." *Tex. Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 643 (1983); *see also* Pet. Br. 33-35.

As it did in its opposition to Leegin's petition for a writ of certiorari, PSKS points to a handful of supposed congressional statements or actions that relate to resale price maintenance, but none of these measures requires that resale price maintenance be treated as *per se* unlawful. For example, as discussed in Leegin's opening brief, the appropriations measures in the 1980s in no way limit this Court's mandate to determine what conduct constitutes an unreasonable restraint of trade. *See* Pet. Br. 35.

PSKS argues that "Congress has continued to be active in the area of vertical RPM in more recent years as well," but it curiously follows that statement with a description of a decision of a working group of the Antitrust Modernization Commission ("AMC") not to study the *per se* rule against resale price maintenance. Resp. Br. 15. In discussing the AMC's decision not to study the rule of *Dr. Miles*, PSKS conveniently omits mention of the AMC's explanation that it should "stand aside and let the common law process work." AMC Working Group Mem. 16 (Dec. 21, 2004), *at* http://www.amc.gov/pdf/meetings/Single-FirmConduct.pdf. That reasoning hardly supports PSKS's position here.

PSKS also quotes statements from the 1998 floor debate in connection with the failed Trademark Anticounterfeiting Act, and argues that Congress's failure to pass that statute

indicates that Congress "preserved" the *per se* prohibition against resale price maintenance. Resp. Br. 16. The opinion of one legislator in connection with unsuccessful trademark legislation, however, is obviously not an appropriate ground upon which to rest an interpretation of the Sherman Act. *See, e.g., United States v. Craft*, 535 U.S. 274, 287 (2002) ("failed legislative proposals are 'a particularly dangerous ground on which to rest an interpretation of a prior statute'").

B. PSKS's Unsubstantiated Speculation About The Consequences Of Rule-Of-Reason Treatment Does Not Support Retaining The Rule Of *Dr. Miles*.

PSKS and its *amici* offer a parade of horribles that will supposedly befall consumers and competition if the rule of *Dr. Miles* were overturned. Resp. Br. 26-28. These concerns are merely rhetorical theories and misguided predictions, none of which justifies retaining the rule of *Dr. Miles*.

1. PSKS expresses concern that resale price maintenance could be used "to facilitate cartelizing a market." Resp. Br. 25-26. As Leegin has explained, however, situations in which resale price maintenance can even plausibly be used to facilitate a cartel are rare. *See* Pet. Br. 21. Moreover, adopting rule-of-reason treatment for resale price maintenance would not legalize cartels, which would still be subject to the *per se* rules against horizontal collusion, which are aggressively enforced in both civil and criminal proceedings.

PSKS argues that "[t]he inability to meaningfully distinguish between cartels formed by retailers and restrictions imposed by manufacturers was a problem confronted in *Dr. Miles* and it continues today." Resp. Br. 25. As an initial matter, PSKS is incorrect in its characterization of *Dr. Miles*. That decision was not premised on an inability to distinguish between cartels and manufacturer-initiated vertical agreements, but rather the Court's mistaken belief that there is no difference between a horizontal retail cartel and a

manufacturer's distribution restraint. This long-discredited notion simply cannot support retaining the rule of *Dr. Miles*.[11]

Moreover, PSKS offers no basis for retaining a *per se* rule based on a supposed difficulty in differentiating between horizontal cartels and manufacturer-imposed vertical restraints. This Court addressed a similar argument in *Sylvania*, explaining that while "[t]here may be occasional problems in differentiating vertical restrictions from horizontal restrictions originating in agreements among the retailers," any such problems of proof are not "sufficiently great to justify a *per se* rule." 433 U.S. at 58 n.28.

2. PSKS and its *amici* also express concern about non-collusive but anticompetitive uses of resale price maintenance. *See, e.g.*, Resp. Br. 26; AAI Br. 26. Leegin, however, is not urging that all uses of resale price maintenance should be *per se lawful*, but rather that resale price maintenance agreements should be evaluated under the rule of reason. *See* Pet. Br. 5-7. Where resale price maintenance is used for anticompetitive purposes, the practice will continue to be subject to antitrust liability under the rule of reason.

PSKS argues that a retailer might pressure a manufacturer to adopt resale price maintenance to avoid retail competition, and it suggests that the *per se* rule should be retained to guard against such situations. Resp. Br. 26. This Court

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[11] *See, e.g.*, 7 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶ 1620d (2d ed. 2004) ("To the extent that *Dr. Miles* rests on the false categorical propositions that resale price maintenance never benefits manufacturers and always has the same effects as an illegal dealer cartel, its ruling is ripe for a reexamination the Supreme Court has never given it."); Robert H. Bork, *The Antitrust Paradox* 298 (1978) ("This field of law can be made clear, internally consistent, and congruent with reality only when we face the fact that the premise laid down in *Dr. Miles*—that the vertical elimination of dealer rivalry has the same effect as a horizontal cartel—is incorrect and must be rejected.").

rejected an analogous concern in *Sharp*, which arose out of pressure by a powerful retailer on a manufacturer to terminate a price-cutting retailer. 485 U.S. at 721. The Court explained that a fear of "dominant retail power . . . does not possibly justify adopting a rule of *per se* illegality. Retail market power is rare, because of the usual presence of interbrand competition and other dealers, and it should therefore not be assumed but rather must be proved." *Id.* at 727 n.2.

One of PSKS's *amici* argues that "the *Sylvania* rule of reason, as applied by the lower courts, has resulted in a rule of *de facto* per se legality for nonprice vertical restraints." AAI Br. 27. This argument is puzzling, at best. If the consequences of anticompetitive uses of vertical restraints are as dire as the AAI suggests, then it should not be difficult to prosecute such uses under the rule of reason. On the other hand, if there really are so few instances in which vertical restraints lead to substantial anticompetitive effects that rule-of-reason treatment approaches a "rule of *de facto* per se legality," then it cannot be the case that a rule of *per se* illegality is appropriate. In any event, the experience of the post-*Sylvania* era clearly demonstrates that vertical restraints cases can be pursued under the rule of reason.[12] There is no basis to suggest that the rule of reason—"the prevailing standard of analysis" under Section 1 of the Sherman Act (*Sylvania*, 433 U.S. at 49)—is somehow inadequate.

3. PSKS further argues that "[o]verturning the rule of *Dr. Miles* would take away the ability of the average consumer to comparison shop for goods." Resp. Br. 19. This argument reflects a fundamental misunderstanding of resale price maintenance agreements.

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12 For example, the FTC secured consent decrees in an enforcement action against several music companies regarding their vertical cooperative advertising programs, in which the FTC maintained that the vertical pricing policies violated the rule of reason. FTC, Analysis to Aid Public Comment (2000), *at* http://www.ftc.gov/os/2000/05/mapanalysis.htm.

When a manufacturer uses resale price maintenance, consumers who wish to "shop for a better price" (Resp. Br. 18) will still have all of the choices that are driven by interbrand competition. As this Court explained in *Sylvania*, "[t]he degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be . . . no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry." 433 U.S. at 52 n.19. The market for women's fashion accessories, in which Leegin competes, illustrates this principle. Even without intrabrand price competition among distributors of Brighton-brand purses or belts, consumers can shop among numerous other brands based on price, style, quality, service, or any other criteria that may impact consumer choice. *See* Expert Report of Kenneth G. Elzinga at 19-20 (Pet. App. 36a-37a). The choices available to consumers range from the higher-priced brands sold through retailers such as Neiman Marcus and Saks Fifth Avenue, to the lower-priced brands sold through retailers such as Wal-Mart and Target. *Id.* Leegin's use of resale price maintenance clearly has not denied consumers the opportunity to comparison-shop among numerous product options at higher and lower retail prices.

In addition, overturning the rule of *Dr. Miles* will not dampen consumers' ability to "pick a retailer based upon services offered in conjunction with a particular article," as PSKS speculates (Resp. Br. 18). Indeed, manufacturers frequently adopt vertical distribution restraints to foster service competition among the retailers of the manufacturer's product. *See, e.g., Sharp*, 485 U.S. at 728. It is precisely because consumers have the ability to comparison-shop based on services and other nonprice criteria that manufacturers implement such programs. Consumer choice drives retailers to compete through sales-related services and thereby improves the manufacturer's interbrand competitive positioning.

Significantly, resale price maintenance is *less* restrictive of intrabrand competition than territorial restraints, which this Court held to be subject to rule-of-reason treatment in *Sylvania*. While vertical territorial restraints eliminate all intrabrand retail competition, resale price maintenance permits and often encourages nonprice competition among retailers of a brand in the same geographic market. *See* Pet. Br. 30 n.13; Br. of Economists 17. PSKS simply ignores this dimension of intrabrand competition under resale price maintenance arrangements.

4. PSKS argues that resale price maintenance should be *per se* unlawful because "most customers prefer stores offering lower prices over those offering greater services" and resale price maintenance might induce retailers to provide more services than consumers really want. Resp. Br. 27. Similarly, PSKS argues that the prohibition on resale price maintenance is desirable because it fosters "the development of larger discount retailers." *Id.* at 18. That many consumers purchase products through discount channels simply does not justify *per se* condemnation of any vertical restraint, including resale price maintenance. It is not the purpose of the antitrust laws to put a thumb on the scale in favor of "larger discount retailers" and reduce diversity in product distribution by discouraging manufacturers from distributing through retailers that provide more point-of-sale services.[13]

At a fundamental level, PSKS and its *amici* seek to skew the combination of price and nonprice competition in favor of price competition. *See, e.g.*, Resp. Br. 29 ("it is imperative to safeguard practices that result in lower consumer prices").

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[13] As recognized by an article relied upon by PSKS, the trend in favor of discount retailers may reflect an overall *loss* in consumer welfare because of "the loss of information services engendered by the prohibition of RPM." David W. Boyd, *From "Mom & Pop" to Wal-Mart: The Impact of the Consumer Goods Pricing Act of 1975 on the Retail Sector in the United States*, 31 J. Econ. Issues 223, 231 (1997).

It is not the function of the Sherman Act, however, to regulate a manufacturer's choices as to how to strike a balance between competing on price, service, promotion, or other product characteristics—interbrand competition is a far better regulator of those choices. If consumers want to purchase particular products or brands through discount channels, market forces will prompt manufacturers to adopt practices that support such channels. Antitrust regulation of these choices is unnecessary and undesirable.

5. One of PSKS's *amici* argues that manufacturers have "less restrictive alternatives" to resale price maintenance, such as paying retailers for performing specified services. *See* AAI Br. 21-22. The Court rejected this argument in *Sylvania*, where it explained that "[t]he location restriction used by Sylvania was neither the least nor the most restrictive provision that it could have used." 433 U.S. at 58 n.29. As the Court recognized, prohibiting one method of product promotion will simply result in "a shift to less efficient methods of obtaining the same promotional effects." *Id.* at 56 n.25.[14]

Similarly, the AAI argues that "nonprice vertical restraints are more likely to have procompetitive benefits than RPM." AAI Br. 24. The potential for procompetitive benefits from various vertical arrangements, however, depends on the nature of the product. For example, Leegin was selling varying amounts of its products to approximately 5000 retailers nationwide. It is not practical for a manufacturer to establish exclusive retail territories when it is selling belts

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[14] The AAI's argument undermines the notion that overturning the rule of *Dr. Miles* would necessarily result in higher retail prices. Whether the manufacturer pays retailers directly to promote its products or shifts the promotional costs to retailers via a guaranteed minimum margin, the cost of promotional efforts is passed through to consumers. Where the manufacturer has the ability to choose the most efficient method of ensuring that its products are adequately promoted, the costs that are passed through to consumers—and, consequently, retail prices—will be lower.

and handbags, as opposed, for example, to earth-moving equipment. Likewise, it is not efficient for a manufacturer to enter into separate contracts with each of thousands of retailers to specify all of the tasks that each retailer should perform to promote the manufacturer's belts and handbags. In these circumstances, resale price maintenance may well be the most efficient method to achieve procompetitive benefits.

IV. PSKS'S ARGUMENT ABOUT A PURPORTED HORIZONTAL CARTEL SHOULD BE REJECTED.

PSKS argues that Leegin's vertical pricing policy should be viewed as a *per se* unlawful horizontal agreement because Leegin owns approximately 70 retail outlets among the approximately 5000 retail stores that sell Leegin's products. Resp. Br. 29-31. Based on this dual-distribution approach, PSKS argues that the verdict below should be affirmed. *Id.* The Court considered and rejected this argument in granting Leegin's petition for a writ of certiorari, and PSKS offers no basis to support a different outcome now. *See United States v. Williams*, 504 U.S. 36, 40 (1992).

Moreover, PSKS never raised this argument below. Prior to its opposition to Leegin's petition for a writ of certiorari, PSKS never argued that *per se* treatment is appropriate for any reason other than *Dr. Miles*' *per se* prohibition on vertical resale price maintenance.[15] The courts below never addressed PSKS's eleventh-hour horizontal theory, but rather

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[15] For example, in seeking to exclude the testimony of Professor Elzinga, PSKS argued to the district court: "[A]greements fixing the minimum retail price of goods are per se illegal. Because it does not matter whether the agreement arose out of a horizontal combination, Elzinga's opinions are not relevant. . . . In this case, Leegin conspired with its dealers to establish a minimum resale price for Leegin's products . . . . Such actions are vertical price restraints and, thus, amount to *per se* violations of the Sherman Act." PSKS Mot. to Limit the Testimony of Kenneth G. Elzinga 4 (Mar. 5, 2004, Dist. Ct. Docket Entry 42).

based their holdings on the rule of *Dr. Miles*. *See* Reply Br. in Support of Pet. for Writ of Cert. 2 n.1.

There is nothing novel or pernicious about a restraint on intrabrand retail competition established by a dual-distributing manufacturer. This Court and numerous lower courts have rejected attempts to characterize such arrangements as *per se* unlawful horizontal agreements. *See id.* at 3 n.2. Leegin has no incentive to organize a cartel among its retailers, as any effort to promote supracompetitive profits for retailers of Leegin's products would simply divert traffic to the numerous other brands sold in countless other outlets and reduce the volume of Leegin's own sales. *See R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!*, 462 F.3d 690, 696-97 (7th Cir. 2006). Moreover, competition at the retail level is heightened when a manufacturer establishes its own outlets that compete with its distributors. Accordingly, "[d]ual distribution . . . does not subject to the per se ban a practice that would be lawful if the manufacturer were not selling direct to customers; antitrust laws encourage rather than forbid this extra competition." *Ill. Corporate Travel, Inc. v. Am. Airlines, Inc.*, 889 F.2d 751, 753 (7th Cir. 1989).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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March 16, 2007

1/22/06

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No. 06-480

In the Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
PETITIONER

v.

PSKS, INC., dba KAY'S KLOSET... KAY'S SHOES

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether vertical minimum resale price maintenance agreements should be deemed per se illegal under Section 1 of the Sherman Act, 15 U.S.C. 1, or whether they should instead be evaluated under the rule of reason.

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AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

The United States Department of Justice and the Federal Trade Commission have primary responsibility for enforcing the federal antitrust laws. The question in this case is whether an agreement between a supplier and its dealer that sets the dealer's minimum retail price constitutes a per se violation of Section 1 of the Sherman Act, 15 U.S.C. 1, or is instead properly analyzed under the rule of reason. The Court's resolution of that question may affect both federal antitrust enforcement and the extent to which private enforcement of the antitrust laws achieves its intended purpose.

STATEMENT

1. Petitioner manufactures women's accessories, including handbags, shoes, and jewelry, that are sold through retailers under the Brighton brand. Pet. App. 2a, 19a n.1. In 1997, petitioner instituted the "Brighton Retail Pricing and Promotion Policy," under which it would sell its products to only those retailers that followed its suggested resale prices. Subsequently, as part of a new marketing initiative, petitioner insisted that its retailers pledge to comply with petitioner's pricing policy in order to become a Brighton Heart Store. *Id.* at 2a.

Respondent is a retailer of Brighton products. After learning that respondent had discounted its entire line of Brighton products, petitioner suspended all shipment of its products to respondent. "As a result, [respondent's] sales and profits decreased substantially." Pet. App. 3a.

Respondent filed the instant suit, alleging that petitioner had "entered into illegal agreements with retailers to fix Brighton products' prices and terminated [respondent] as a result of those agreements," in violation of the Sherman Act, 15 U.S.C. 1. Pet. App. 3a. Petitioner sought to introduce into evidence the report of its expert economist, Professor Kenneth Elzinga, who concluded that petitioner's "business model, including its use of Suggested Retail Prices, is procompetitive." *Id.* at 18a, 20a. Relying on this Court's decision in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911) (*Dr. Miles*), the district court excluded Professor Elzinga's report on the ground that "[v]ertical minimum price fixing agreements * * * remain per se unlawful." Mem. Op. and Order 4 (Mar. 25, 2004). The jury found petitioner liable and awarded damages of $1.2 million. Pet. App. 7a.

2. The court of appeals affirmed. Pet. App. 1a-11a. Petitioner did not challenge the jury's finding that it had entered into an agreement to fix the minimum price at which its dealers would sell its products, but rather challenged the application of a per se rule to its conduct. *Id.* at 3a. The court of appeals rejected petitioner's contention, concluding that it "remain[ed] bound by [this Court's] holding in *Dr. Miles*." *Id.* at 4a. The court of appeals also found that the trial court had properly excluded Professor's Elzinga's report. The court explained that "[w]ith the *per se* rule, expert testimony regarding economic conditions and the pricing policy's pro-competitive effects is *not* relevant." *Id.* at 5a-6a.

SUMMARY OF THE ARGUMENT

The per se rule against vertical minimum resale price maintenance (RPM) established in *Dr. Miles* is irreconcilable with this Court's modern antitrust jurisprudence and cannot withstand analysis. That per se rule should be abandoned, and *Dr. Miles* should be overruled.

A. This Court's antitrust decisions make clear that the presumptive standard for assessing the legality of challenged conduct is the rule of reason, which examines the reasonableness of a given restraint in the context of a particular case. Per se condemnation of economic restraints under Section 1 of the Sherman Act, 15 U.S.C. 1, is thus exceptional, and is reserved for restraints that always, or almost always, reduce consumer welfare by limiting competition and output. Per se treatment is inappropriate when the economic impact of the type of conduct at issue is not obviously and predictably anti-competitive.

B. Because the effects of RPM can be either anti-competitive or procompetitive depending on the facts in

a given case, a per se rule is clearly inappropriate. There is a widespread consensus of opinion that RPM, like non-price vertical restraints, can have a variety of procompetitive effects that enhance consumer welfare. By reducing *intra*brand competition, RPM can stimulate *inter*brand competition by giving retailers incentives to promote the manufacturer's brand in ways that are desirable for both consumers and the manufacturer. RPM may ensure sufficient margins and incentives for retailers to engage in beneficial point-of-sale services, because it prevents "free riding" by price-cutting dealers that would otherwise make it unprofitable for retailers to incur the cost of providing those services. That potential is magnified by the advent of high-volume Internet retailers. Even absent free riding, RPM may give retailers economic incentives to make additional non-price sales efforts, such as investing in attractive stores and locations or stocking greater quantities of a product in the face of uncertain consumer demand. And, at least for some products, RPM may also serve the manufacturer's interest in preserving brand reputation and consumer loyalty.

C. The reasons suggested for continuation of a per se rule are unpersuasive. The decision in *Dr. Miles* is premised on outdated rationales and principles that have been undermined by subsequent decisions of this Court and cannot withstand modern economic analysis. Common law concerns about restraints on alienation are not relevant to whether a practice is so likely to be anticompetitive as to warrant per se condemnation. Moreover, the belief expressed in *Dr. Miles* that RPM is the functional equivalent of a price-fixing agreement among dealers comports with neither fact nor logic; manufacturers are typically the source of RPM require-

ments, yet they have no economic incentive to enrich dealers with supra-competitive profits while reducing their own sales.

To be sure, RPM limits intrabrand price competition and in some circumstances can harm consumer welfare by supporting cartel efforts by manufacturers or dealers. But non-price vertical restraints can also harm consumer welfare, yet they are subject to the rule of reason. *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977). Nor is there any basis for presuming that RPM will always or almost always support cartel efforts. Likewise, indirect indication of past congressional support for the per se rule of *Dr. Miles* does not counsel against this Court's revisiting the issue in light of subsequent decisions and modern economic analysis.

D. The principle of stare decisis does not justify reaffirmation of *Dr. Miles*. That principle has less force in the antitrust context, because Congress expected this Court to give continuing shape to the meaning of the antitrust laws in keeping with "changed circumstances and the lessons of accumulated experience." *State Oil Co.* v. *Khan*, 522 U.S. 3, 20 (1997). That is particularly true with respect to decisions applying the per se rule, rather than the rule of reason, because that choice is based on experience and economic analysis of particular economic behavior. If experience or economic analysis points in a different direction over time, there is no basis for maintaining a clearly outdated rule. This Court thus has overruled per se prohibitions against non-price vertical restraints and maximum vertical price restraints when "the theoretical underpinnings of those decisions" have been "called into serious question." *Id.* at 21. There is no justification for retaining an anomalous per se ban on

RPM that has no basis in modern antitrust doctrine or experience.

ARGUMENT

THIS COURT SHOULD OVERRULE *DR. MILES* AND SUBJECT RESALE PRICE MAINTENANCE TO THE RULE OF REASON

The decision in *Dr. Miles* was based on reasoning and economic assumptions that predate and conflict with modern economic theory. More importantly, the per se ban on RPM cannot survive subsequent decisions of this Court, which make clear that per se condemnation is appropriate only for those categories of conduct that are manifestly anticompetitive. Thus, in *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the Court overruled the per se prohibition against vertical nonprice agreements established by *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), because such agreements could not be shown to meet the demanding standards for imposition of a per se rule. Similarly, this Court in *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997), overruled the per se ban on vertical maximum price-fixing agreements established by *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1965), in light of subsequent cases and the absence of a sufficient economic justification for a per se rule. Similar considerations compel the conclusion that *Dr. Miles* should be overruled, and that RPM should be evaluated under the same rule-of-reason standard that applies to other vertical agreements.

A. Per Se Condemnation Applies Only To Restraints That Are Almost Invariably Anticompetitive

1. Section 1 of the Sherman Act, 15 U.S.C. 1, declares every "contract, combination * * *, or conspiracy, in

restraint of trade * * * to be illegal." In *Dr. Miles*, this Court declared unlawful vertical agreements between a supplier of patent medicines and the wholesalers and retailers of its products concerning the minimum price at which they resold the supplier's medicines. Subsequent decisions of this Court have read *Dr. Miles* to have established a per se rule under which RPM is unlawful without any inquiry into its competitive effects in a particular case. *NYNEX Corp.* v. *Discon, Inc.*, 525 U.S. 128, 133 (1998); *GTE Sylvania*, 433 U.S. at 51 n.18; *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 733 (1988); *United States* v. *Bausch & Lomb Optical Co.*, 321 U.S. 707, 720 (1944); *United States* v. *Trenton Potteries*, 273 U.S. 392, 401 (1927).

Dr. Miles was decided at the dawn of this Court's antitrust jurisprudence. Subsequent decisions have considerably clarified, and modified, the proper approach to antitrust analysis. In particular, decisions post-dating *Dr. Miles* have made clear that "most antitrust claims are analyzed under a 'rule of reason,'" which requires evaluation of the reasonableness of the challenged restraint in the factual context of a specific case. *Khan*, 522 U.S. at 10; *GTE Sylvania*, 433 U.S. at 49 (observing that the rule of reason is "the prevailing standard.").

By contrast, this Court has concluded that per se condemnation, which obviates the need for proof of the arrangement's effect in a given case, is to be reserved for restraints that are "manifestly anticompetitive," *GTE Sylvania*, 433 U.S. at 49-50, and "would always or almost always tend to restrict competition and decrease output." *Business Elecs.*, 485 U.S. at 723 (quoting *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-290 (1985)). Under modern antitrust principles, therefore, a per se rule is appropri-

ate only for those restraints, such as horizontal price agreements among competitors, that have a "pernicious effect on competition and lack * * * any redeeming virtue." *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958).

2. The determination that a specific practice should be treated as unlawful per se must rest upon experience in analyzing the practice and examining "the actual impact of these arrangements on competition." *White Motor Co.* v. *United States*, 372 U.S. 253, 263 (1963). Any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line-drawing." *GTE Sylvania*, 433 U.S. at 58-59. Per se condemnation is "appropriate '[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (brackets in original (quoting *Arizona* v. *Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982)).

Application of a per se rule embodies a generalization that "certain kinds of agreements will so often prove so harmful to competition and so rarely prove justified that the antitrust laws do not require proof that an agreement of that kind is, in fact, anticompetitive in the particular circumstances." *NYNEX Corp.*, 525 U.S. at 133. "Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them." *GTE Sylvania*, 433 U.S. at 50 n.16. This Court has accordingly been "reluctan[t] to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately

obvious.'" *Khan*, 522 U.S. at 10 (quoting *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458-459 (1986)).

B. Resale Price Maintenance Does Not Meet This Court's Criteria For Application Of A Per Se Rule

This Court has never analyzed the likely economic effects of RPM, much less found that RPM has a predictably "pernicious effect on competition and lack[s] * * * any redeeming virtue." *Northern Pac. Ry.*, 356 U.S. at 5. Because RPM agreements have been unlawful since the *Dr. Miles* decision in 1911, moreover, lower courts have been precluded from considering evidence of the competitive purposes and effects of particular RPM agreements. Thus, the per se prohibition against RPM has never been justified in accordance with the high standards for imposition of per se rules enunciated in *Northern Pacific* and subsequent decisions of this Court. It is clear that RPM falls far short of the current standard for per se condemnation of a practice.

Although RPM may have anticompetitive effects in a particular case, there is no basis "to predict with confidence that the rule of reason will condemn it" because the practice is invariably or almost invariably anticompetitive and lacking in any redeeming social value. *Khan*, 522 U.S. at 10 (quoting *Maricopa Co. Med. Soc'y*, 457 U.S. at 344). To the contrary, there is a widespread consensus that permitting a manufacturer to control the price at which its goods are sold may promote *inter*brand competition and consumer welfare in a variety of ways. Because "the primary purpose of the antitrust laws is to protect interbrand competition," *Khan*, 522 U.S. at 15; *GTE Sylvania*, 433 U.S. at 52 n.19, RPM cannot be classified as a manifestly anticompetitive practice worthy of per se condemnation.

As Justice White observed in his concurring opinion in *GTE Sylvania*, moreover, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). In reality, "the economic effect of * * * unilateral and concerted vertical price setting, agreements on price[,] and nonprice restrictions * * * is in many, but not all, cases similar or identical." *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984). Thus, as Justice White correctly concluded, the Court's decision to subject vertical non-price restraints to the rule of reason in *GTE Sylvania* "necessarily * * * calls[s] into question" application of the per se rule to vertical price restraints generally. 433 U.S. at 70 (White, J., concurring). There is simply no basis for subjecting RPM to per se analysis while analyzing nonprice vertical restraints and maximum resale price maintenance under the rule of reason.

1. RPM will often have procompetitive justifications because it can stimulate interbrand competition

A manufacturer naturally seeks to make additional sales by better serving consumers' interests. Those interests are not limited to low prices, but may include other factors such as access to product demonstration and service; convenience of store hours and location; and knowledgeable, pleasant, and efficient sales personnel. Unless the manufacturer sells directly to consumers, it must rely on its retailers to help it achieve its goals. The interests of retailers and manufacturers, however, do not always coincide. While manufacturers generally benefit from dealer efforts to increase sales by lowering retail

prices, in some circumstances other forms of sales efforts may better serve the interests of both consumers and manufacturers, even if not the dealers.

By fixing the minimum price at which the good may be sold (and thus guaranteeing the retailer a certain margin over the cost of the good to the retailer), RPM provides retailers with an incentive to expend resources in order to attract additional customers for that product, thereby furthering the manufacturer's competitive goals. RPM thus can have the same types of procompetitive effects recognized in *GTE Sylvania* with respect to nonprice vertical restraints such as exclusive territories. "Resale price maintenance, like other vertical restraints, is typically a response to a supplier's problem of inducing distributors to provide adequate levels of distribution for its products." Section of Antitrust Law, ABA, *Antitrust Law and Economics of Product Distribution*, 58 (2006); Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. L. & Econ. 285, 322-325 (1996) (concluding that RPM challenged by the FTC was most likely employed to increase distribution of the products). In other words, by limiting intrabrand price competition, the manufacturer may induce its distributors to provide promotional services and sales efforts and thereby increase the attractiveness of the product. RPM thus may "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." *GTE Sylvania*, 433 U.S. at 54.

"For example, new manufacturers and manufacturers entering new markets can use [RPM] in order to induce * * * retailers to make the kind of investment of capital and labor that is often required in the distribution of

products unknown to the consumer." *GTE Sylvania*, 433 U.S. at 55; see Pet. App. 36a (Elzinga Report) ("Leegin's pricing policy is designed to induce and incent store-owners and sales personnel to promote the Brighton line, and to enable Leegin to compete with larger department stores offering more prominent brands."). "Established manufacturers can use [RPM] to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their product." *GTE Sylvania*, 433 U.S. at 55.

RPM thus accomplishes directly what nonprice vertical restraints accomplish indirectly. *Business Elecs. Corp.*, 485 U.S. at 727-729; *Monsanto*, 465 U.S. at 762; accord Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 156 (1984) (Easterbrook). As this Court has acknowledged, "all vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that." *Business Elecs.*, 485 U.S. at 728. "In fact, vertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services." *Ibid.* Like other vertical restraints, therefore, RPM has complex competitive effects because of its "simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *GTE Sylvania*, 433 U.S. at 51-52.

2. RPM may reduce retailers' incentives to engage in free riding

"There is a consensus in the economic literature that minimum RPM can, in certain circumstances, remedy a

free-riding problem and thereby increase competition and enhance consumer welfare." Economists Pet. Stage Amici Br. 5 (Economists Br.). The most prominent pro-competitive rationale for RPM is that it may alleviate a free-riding problem when retailers incur costs to promote the manufacturer's brand through point-of-sale services. For example, a manufacturer may want its retailers to provide an in-store demonstration or exhibition of a product's features and selections. Such services may be the best way to educate consumers about the product and to promote sales. As is the case with vertical non-price restraints, see *GTE Sylvania*, 433 U.S. at 55, however, an individual retailer has an incentive to free ride on the provision of those services by rival retailers. A retailer offering no services but a lower price can sell to consumers who have been educated by retailers that do provide the services desired by the manufacturer and the consumer. The problem is exacerbated by catalog retailing and the advent of the Internet, as consumers may visit traditional, brick-and-mortar retailers to examine a product and select its features but then purchase the product at a discounted price from a catalog or on-line retailer, whose very lack of "bricks and mortar" affords point-of-sale services impossible and whose lack of expenses for bricks and mortar gives them a competitive advantage over traditional retailers who provide the services that some manufacturers desire.

If free riding is extensive, few if any retailers will incur the costs necessary to provide the services for product promotion, and consumers will not be educated about the manufacturer's product, "despite the fact that each retailer's benefit would be greater if all provided the services than if none did." *GTE Sylvania*, 422 U.S. at 55; accord *Business Elecs.*, 485 U.S. at 731; *Monsanto*,

465 U.S. at 762. RPM reduces or eliminates the incentive to free ride by eliminating the opportunity to attract customers through price cutting. Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 89-96 (1960).

Manufacturers similarly may rely on RPM to give certain prestige retailers an incentive to stock and promote the manufacturer's product. Prestige retailers have developed reputations for stocking only high quality or especially fashionable products, which may be costly for the retailers to identify. Many customers may evaluate products largely on the basis of the stocking choices made by the prestige retailers—an effect known as quality certification or signaling. Other retailers may seek to sell at a discount the same products stocked by prestige retailers, thereby free riding on the prestige retailers' quality certifications. When quality certification is important to consumers, a manufacturer's best strategy may be to impose RPM, which induces prestige retailers to carry its product when free riding otherwise would make it unprofitable to do so. Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 Antitrust L.J. 59, 65-67 (1994) (Marvel); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346 (1984) (Marvel & McCafferty); Ronald N. Lafferty et al., *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases* 34-35 (FTC 1984); Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 56-62 (FTC 1983) (Overstreet).

3. RPM may promote the sale of the manufacturer's product even absent free riding

Even in the absence of free riding, RPM may help the manufacturer encourage retailers to sell its products vis-a-vis rival brands.[1] By ensuring retailers an adequate margin over the wholesale price of the product, RPM provides retailers with an incentive to make non-price sales efforts that attract customers away from other brands. Such sales efforts extend beyond product exhibition and demonstration, on which other retailers can free ride, and include such factors as the attractiveness and location of retail stores and the speed and efficiency with which retailers complete customer transactions, factors that do not lend themselves to free riding by other retailers. A retailer can increase its sales either by cutting prices or by increasing sales efforts, but the manufacturer's sales will not increase unless the retailer takes steps to take sales from rival brands. Manufacturers can give retailers an incentive to compete harder against rival brands by using RPM to ensure that retailers compete in non-price areas and can make a profit while providing the manufacturer's desired level of sales efforts. Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 55, 67-69, 72-73 (1998); Ralph A. Winter, *Vertical*

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[1] It is always in the interest of the manufacturer to make its product attractive to consumers, and controlling retailer discounting may be seen as an important component of a strategy to do so. Petitioner explains that "it was [petitioner's] view that the typical retail strategy of putting products on and off 'sale' degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment." Pet. 3. In addition, price may be associated with a brand's reputation and identity.

Control and Price Versus Nonprice Competition, 108 Q.J. Econ. 61 (1993).

RPM also may encourage retailers to stock the product at the manufacturer's desired level when uncertainties in consumer demand could otherwise limit the quantity purchased by the retailer. Although retailers typically charge high prices to consumers when demand is strong and low prices when demand is weak, under certain circumstances, RPM may cause retailers to charge lower prices than they otherwise would when demand is strong because RPM limits the retailers' losses when demand is weak. Thus, RPM may induce retailers to carry larger inventories, benefitting both the manufacturer and consumers by assuring the continuous availability of the brand to consumers. Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996).

C. The Various Justifications That Have Been Offered For The Per Se Ban On RPM Do Not Withstand Scrutiny

1. Dr. Miles's *reasoning has been thoroughly undermined by this Court's precedents*

a. In rejecting the manufacturer's claim that it was entitled to control the price at which its goods would be sold, *Dr. Miles* relied on the common law proposition that "a general restraint upon alienation is ordinarily invalid." 220 U.S. at 404. In *Business Electronics*, 485 U.S. at 733, this Court described *Dr. Miles*'s per se rule as "based largely on the perception that [a RPM] agreement was categorically impermissible at common law" as "an unlawful restraint on alienation."

As this Court observed in *GTE Sylvania*, however, the common law notion disfavoring restraints on alienation has been subjected to near-universal criticism by antitrust commentators. 433 U.S. at 53 n.21. While that common-law rule may have had resonance with the *Lochner*-era Court, it has limited utility in interpreting the antitrust statutes. The *GTE Sylvania* Court refused to rely on that "ancient rule," holding instead that "the state of the common law 400 or even 100 years ago is irrelevant" to modern antitrust analysis. *Ibid.* (quoting *Arnold, Schwinn & Co.*, 388 U.S. at 392 (Stewart, J., dissenting)). Accordingly, the principal rationale relied upon by the *Dr. Miles* decision is invalid, and cannot justify continued maintenance of the per se ban on RPM.

In *Simpson* v. *Union Oil Co.*, 377 U.S. 13, 16 (1964), the Court identified a closely related rationale for the *Dr. Miles* rule, stating that RPM injured commerce because it was "depriving independent dealers of the exercise of free judgment" in selling the product at a price determined by the dealer. But, of course, dealers remain free to exercise their judgment in deciding to enter a contractual relationship with a supplier. Equally important, the suppliers who perceive significant benefits from controlling retail prices retain the freedom to terminate non-complying dealers, see *United States* v. *Colgate & Co.*, 250 U.S. 300, 306-307 (1919), or even to enter the retail market themselves and eliminate the independent retailers (and their free judgment) altogether. For that reason, the Court held in *Khan*, 522 U.S. at 16, that "interfere[nce] with dealer freedom" could not support a per se ban on vertical maximum price fixing. Thus, the goal of protecting "dealer freedom" cannot support the continued application of the per se prohibition against RPM. And in any event, "impairment

of dealer freedom alone is not sufficient to constitute an unreasonable restraint of trade." 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1609, at 114-115 (2d ed. 2004); see *GTE Sylvania*, 433 U.S. at 53 n.21.

b. The Court in *Dr. Miles* also expressed the view that greater profits from RPM would benefit the dealers, not the manufacturer, and the Court reasoned that RPM would be equivalent to a price-fixing agreement among dealers. 220 U.S. at 407-408. But RPM generally emanates from the *manufacturer*, who has no economic incentive to encourage supra-competitive prices by its dealers. Quite to the contrary, a price-fixing conspiracy at the retail level presumably would reduce quantities sold and thereby reduce the manufacturer's profits. Richard A. Posner, *Antitrust Law* 177 (2d ed. 2001); Robert H. Bork, *The Antitrust Paradox*, 33, 288-290 (1978); see *GTE Sylvania*, 433 U.S. at 56 n.24 ("Generally a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenue.") (quoting Recent Case, *Antitrust Laws—Sherman Act—Vertical Restraints: Enforcement of Resale Location Restrictions is a Per Se Violation of Section One of the Sherman Act*, 88 Harv. L. Rev. 636, 641 (1975)). As Justice Holmes' dissenting opinion in *Dr. Miles* pointed out, the manufacturer is in the best position to determine "what will enable it to do the best business." 220 U.S. at 412.

2. The remaining proffered justifications for the per se rule do not support its retention

a. In *GTE Sylvania*, the Court suggested possible reasons that could justify the continued per se illegality of RPM and distinguish RPM from nonprice vertical restraints. 433 U.S. at 51 n.18. None of the concerns ex-

pressed in *GTE Sylvania* justifies the continued characterization of RPM as a per se offense.

First, the Court noted Justice Brennan's earlier assertion in his concurring opinion in *White Motor Co.*, 372 U.S. at 268, that, unlike vertical nonprice restraints, RPM "almost invariably" reduces interbrand competition. But Justice Brennan did not identify any theoretical explanation or empirical support for that assertion, and the intervening years have not filled either void. To the contrary, as the Court recognized in *GTE Sylvania* itself, the impact of vertical restraints is generally *constrained* by interbrand competition: "when interbrand competition exists, * * * it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." 433 U.S. at 52 n.19. And if a manufacturer does possess interbrand market power, it is not likely to use RPM as a way to raise resale prices; if elevation of resale price were the manufacturer's ultimate purpose, the manufacturer could simply raise its own price to the distributor and thereby keep for itself any higher revenues resulting from the higher price.

Economists have observed, moreover, that nonprice vertical restraints, such as exclusive territories, can more completely restrict intrabrand competition than does RPM. While exclusive territorial restrictions can eliminate virtually all intrabrand competition, RPM permits retailers to engage in intrabrand competition on factors other than price, "leav[ing] multiple sellers of the brand in the same geographic market to engage in interbrand competition." Economist Br. 17; Richard A. Posner, *The Next Step in Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 9 (1981) ("Resale price maintenance is more flexible than

exclusive territories as a method of limiting price competition among dealers.").

Second, the Court in *GTE Sylvania* noted that RPM may facilitate cartelization. 433 U.S. at 51 n.18.[2] That possibility is a reason to subject RPM to the rule of reason. However, there is no basis in evidence or experience to predict that RPM "would always or almost always" be condemned under that standard. *Business Elecs.*, 485 U.S. at 723 (quoting *Northwest Wholesale Stationers, Inc.*, 472 U.S. at 289). Studies of RPM cases over many years have found relatively few instances of such anticompetitive uses of RPM. An analysis of all litigated RPM cases during 1976-1982 concluded that "collusion theories do not seem capable of explaining at least 85 percent of the cases." Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 292 (1991).[3] In any event, all cartel agreements are illegal per se, regardless

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[2] Manufacturers could use RPM, particularly when combined with exclusive dealing arrangements with their retailers, to facilitate a price-fixing conspiracy by enhancing their ability to detect departures from agreed-upon prices. In addition, retailers might act collectively to coerce a manufacturer to institute RPM as a means of thwarting competition from a discounting retail competitor. *Business Elecs.*, 485 U.S. at 725-726; Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & Econ. 363, 365-369, 373-378 (1985); Overstreet 13-23.

[3] Another study found that only 7% of the horizontal conspiracy cases filed by the Department of Justice during 1890-1983 involved resale price maintenance. Stanley I. Ornstein, *Resale Price Maintenance and Cartels*, 30 Antitrust Bull. 401, 416-417 (1985). The same study found that only 10% of RPM complaints brought by the FTC during 1942-1983 involved cartels. *Id.* at 423. Still another report found that a "substantial portion of the [FTC]'s RPM enforcement efforts [from 1965-1982] have been concentrated in markets which appear to be structurally competitive." Overstreet 74.

of whether the cartel uses RPM. And the rule of reason would condemn any RPM demonstrated to be a means of supporting a cartel. Cf. *Khan*, 522 U.S. at 22 ("In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct.").

Third, the Court in *GTE Sylvania* also cited past congressional action as indicating congressional "approval of a *per se* analysis of vertical price restrictions." 433 U.S. at 51 n.18. The Court referred to the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, amending 15 U.S.C. 1, 45(a) (1970), which had repealed provisions of earlier statutes which allowed "fair trade" pricing, *i.e.*, RPM, at the option of individual States. Congress subsequently enacted temporary prohibitions, no longer in effect, on the Department of Justice's use of appropriated funds to advocate the overruling of *Dr. Miles*. J. Res of Nov. 14, 1983, Pub. L. No. 98-151, §101(e), 97 Stat. 973; Act of Nov. 28, 1983, Pub. L. No. 98-166, §510, 97 Stat. 1102; Act of Dec. 13, 1985, Pub. L. No. 99-180, §605, 99 Stat. 1169.

Those congressional enactments do not support the continued existence of a rule that is dramatically out of step with this Court's modern antitrust jurisprudence. As an initial matter, there is no incongruity between Congress's action in 1975 and a more flexible treatment of RPM under the Sherman Act. In repealing the broad per se *legality* afforded by the fair trade laws and once again subjecting RPM to antitrust scrutiny, Congress did not mandate a particular standard to govern such scrutiny. Easterbrook 139. Although both the House and Senate reports on the 1975 legislation indicate Congress's awareness of the reality that by repealing the exemption for fair trade laws they were remitting RPM

to the *Dr. Miles* regime, H.R. Rep. No. 341, 94th Cong., 1st Sess. 3 (1975) (House Rep.); S. Rep. No. 466, 94th Cong., 1st Sess. 1-2 (1975), the legislative history suggests that Congress merely intended to end a special exemption from the Federal antitrust laws that allowed States to declare RPM per se *legal*. House Rep. 5.

In repealing the special exemption for RPM provided by the fair trade laws, Congress did not purport to freeze that status and deprive this Court of its recognized authority and flexibility to interpret the Sherman Act's general language in accordance with our growing understanding of commercial realities. Easterbrook 139. There is thus no support for the notion that Congress intended to preserve a per se ban on RPM even if subsequent developments in the law rendered that ban anomalous and markedly inconsistent with the treatment of other forms of vertical restraints. Likewise, the earlier prohibitions against the Department's use of appropriated funds to advocate *Dr. Miles*'s demise have not been in effect for over 20 years, and in any event are hardly a testament to the robustness of the *Dr. Miles* rule. Congress could have buttressed the *Dr. Miles* rule directly, and more to the point, retains the full ability to address RPM legislatively. If *Dr. Miles* cannot survive as a matter of stare decisis, see pp. 24-28, *infra*, it should no longer skew any congressional debate concerning RPM.[4]

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[4] Congressional views about RPM and *Dr. Miles* have varied over the years. The 1975 legislation, after all, repealed earlier legislation, the Miller-Tydings Fair Trade Act, ch. 690, tit. VIII, 50 Stat. 693, and the McGuire Bill, ch. 745, 66 Stat. 631, that had been intended to place "the stamp of approval upon price maintenance transactions under State [fair trade laws], notwithstanding the Sherman Act of 1890." 81 Cong. Rec. 8138 (1937) (statement of Rep. Dirksen).

b. It also has been argued that RPM necessarily harms those customers who are already poised to purchase the manufacturer's product without any special dealer services supported by RPM (so-called "inframarginal" customers). According to that argument, RPM forces inframarginal customers to pay more for a product they would have purchased in any event. William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 990-992 (1985) (Comanor). That argument plainly cannot support per se condemnation. Prices need not go up when RPM causes retailers to provide costly additional services, because the manufacturer, in imposing RPM, may lower its wholesale price to retailers. Marvel 67-71; Marvel & McCafferty 369-373. RPM also may spur greater retail sales efforts that increase total output, allowing the manufacturer to achieve economies of scale.

Second, even if inframarginal customers pay higher prices, other customers receive the benefit of products they find more attractive as a result of the enhanced product information and service. In other words, higher prices resulting from RPM may enhance consumer welfare as a whole because consumers effectively receive a different and better product at the higher price. And third, harm to inframarginal customers will generally be limited as long as interbrand competition exists, "because of the ability of consumers to substitute a different brand of the same product." *GTE Sylvania*, 433 U.S. at 52 n.19.

In any event, the per se prohibition against RPM does not prevent manufacturers from engaging in other conduct that achieves similar results. Prevented from using their preferred—and thus presumably most efficient—

marketing strategy, manufacturers can be expected to adopt the best available alternative to RPM. For example, manufacturers might consider relatively inefficient vertical integration or offer services themselves that could be more efficiently produced by retailers, thereby decreasing consumer welfare. See p. 17, *supra*. Even under the *Dr. Miles* rule, moreover, manufacturers may lawfully adopt a policy of terminating retailers for failure to abide by the manufacturer's suggested retail price, as long as they avoid an agreement. *Colgate & Co.*, 250 U.S. at 306-307. Thus, there is little basis for concern that elimination of the *Dr. Miles* rule will permit RPM that always or almost always harms consumer welfare.

D. Considerations Of Stare Decisis Do Not Justify Retention Of The *Dr. Miles* Rule

1. Although this Court approaches the reconsideration of its prior decisions with the "utmost caution," *Khan*, 522 U.S. at 20, the principle of stare decisis is "not an inexorable command." *Ibid.* (quoting *Payne* v. *Tennessee*, 501 U.S. 808, 828 (1991)). "In the area of antitrust law, there is a competing interest, well represented in [the] Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Ibid.* Accordingly, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act" in light of the accepted view that Congress expected courts to give continuing shape to antitrust law. *Ibid.* That is particularly true in the context of per se rules, which are adopted based on experience and economic analysis and should not survive when experience and economic analysis thoroughly undermine the case for per se treatment.

For those reasons, this Court "has reconsidered its decisions construing the Sherman Act when the theoreti-

cal underpinnings of those decisions are called into serious question." *Khan*, 522 U.S. at 21. In an analogous context, this Court recently overruled its prior decisions establishing a presumption that patents confer market power in the context of a tying case, a presumption that did not comport with modern economic reality. *Illinois Tool Works Inc.* v. *Independent Ink, Inc.*, 126 S. Ct. 1281 (2006). Those decisions reflect this Court's reluctance "to create out of the single term 'restraint of trade' a chronologically schizoid statute, in which a 'rule of reason' evolves with new circumstances and new wisdom, but a line of *per se* illegality remains forever fixed where it was." *Khan*, 522 U.S. at 21. There is similarly no justification for retaining an anomalous per se rule that is based on erroneous reasoning and manifestly does not satisfy this Court's modern test for per se treatment. "With the views underlying [*Dr. Miles*] eroded by this Court's precedent, there is not much of that decision to salvage." *Ibid.*

2. *Dr. Miles*'s per se rule has few, if any, defenders in the scholarly community. See *Khan*, 522 U.S. at 15-18 (relying on scholarly criticism in abrogating per se ban on maximum vertical price restraints). As the brief filed at the petition stage by leading economists aptly summarizes:

> In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue.

Economists Br. 15-16.

Even commentators who emphasize the potential anticompetitive effects of vertical restraints generally endorse some form of rule-of-reason analysis that takes into account the economic and market conditions in any given case. For example, Professor Pitofsky, while generally endorsing *Dr. Miles*'s per se rule, has proposed significant exceptions to the rule in light of modern economic realities. Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1488, 1495 (1983).

Similarly, Professor Comanor, who has proposed a per se ban or a "modified rule of reason analysis" for vertical price and nonprice restraints involving "established products," has advocated that, in the case of new products or products of new market entrants, "the restraints should be permissible, or at least should be treated more leniently in any modified rule of reason analysis." Comanor 99, 1001, 1002. Other critics of RPM are no exception. Robert L. Steiner, *How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 Antitrust L.J. 407, 445, 446-447 (1997) (explaining that in some circumstances "the consumer interest is often better served by RPM [as opposed to other vertical restraints]—contrary to its per se illegality and the rule-of-reason status of vertical nonprice restraints"); Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 Antitrust L.J. 83, 135 (1995) (explaining that a "structured rule of reason should be applied to both price and nonprice [vertical] restraints").[5]

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[5] Grimes suggests that, under a properly structured rule-of-reason analysis, RPM would more frequently be found anticompetitive than

3. Continuation of a per se ban on RPM poses significant practical risks to the procompetitive purposes of the antitrust laws. Most saliently, the per se ban on RPM prohibits conduct that would often be efficiency-enhancing and beneficial, with the result that overall economic welfare is reduced. See pp. 9-16, *supra*. Perpetuation of unjustified per se rules also risks undermining the value of per se rules more generally. Per se rules are essential to effective enforcement of the antitrust laws. They establish bright-line tests that identify plainly pernicious conduct, thereby deterring unlawful behavior and providing clear guidance to the business community and antitrust counselors. If a per se rule, once adopted, were to be treated as sacrosanct, it could make courts overly cautious in adopting such rules. Moreover, courts, agencies, and the business community should have confidence that per se rules are applied only to manifestly anticompetitive conduct. Application of a per se rule to conduct that often would be procompetitive has the potential to erode the rationale for per se treatment and foster judicial reluctance to use such a blunt instrument even in those circumstances when it is appropriate.

In *Colgate*, *supra*, the Court held that the antitrust laws permit a manufacturer unilaterally to announce that it will refuse to do business with dealers who sell below the manufacturer's suggested retail price, provided that the dealer does not actually enter into an agreement to maintain retail price. But the distinction between unilateral conduct that is lawful under *Colgate* and an implicit agreement that is illegal per se under *Dr. Miles* is "often * * * difficult to apply in practice." *Monsanto*, 465 U.S. at 762. The distinction has spawned considerable con-

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would some other vertical restraints. Grimes, *supra*, at 119-134. He nevertheless rejects a per se rule in favor of the rule of reason.

cern and uncertainty in the business community and the courts, potentially chilling even procompetitive conduct that might qualify as unilateral under *Colgate*. Cf. *GTE Sylvania*, 433 U.S. at 48 n.14 (discussing distinctions made by lower courts to limit *Schwinn*'s per se reach).

4. Nor does the per se rule of *Dr. Miles* comport with this Court's closely related precedents. As discussed, the Court in *GTE Sylvania* and *Khan* overruled its prior decisions imposing a per se ban on other vertical restraints with effects similar to those of RPM. See pp. 6, 9-10, *supra*. The similarity between RPM and other vertical restraints as to which per se treatment has been abandoned makes the continued survival of *Dr. Miles* impossible to justify. In other contexts, the Court has overruled anachronistic precedents that could not be squared with the reasoning of opinions in closely related cases. *E.g. Lapides* v. *Board of Regents of Univ. Sys.*, 535 U.S. 613, 623 (2002); *Ring* v. *Arizona*, 536 U.S. 584, 602-609 (2002). The same result is appropriate here.

* * * * *

The time has come to harmonize the law's treatment of RPM with modern antitrust doctrine. There is no sound basis for treating RPM differently from other vertical agreements. The rule of reason offers protection against anticompetitive uses of RPM, while allowing defendants to defend their arrangements as legitimate and procompetitive. Moreover, analyzing RPM under the same standards that govern other vertical restraints will avoid the continued necessity to make tenuous distinctions between economically indistinguishable conduct and will promote proper application of the per se rule, to the benefit of strong antitrust enforcement and a vigorously competitive economy.

CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded for further proceedings.

Respectfully submitted.

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JANUARY 2007

No. 06-480

In the Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
PETITIONER

v.

PSKS, INC., dba KAY'S KLOSET... KAY'S SHOES

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether vertical minimum resale price maintenance agreements should be deemed per se illegal under Section 1 of the Sherman Act, 15 U.S.C. 1, or whether they should instead be evaluated under the rule of reason.

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In the Supreme Court of the United States

No. 06-480

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
PETITIONER

v.

PSKS, INC., dba KAY'S KLOSET... KAY'S SHOES

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

The United States Department of Justice and the Federal Trade Commission have primary responsibility for enforcing the federal antitrust laws. The question in this case is whether an agreement between a supplier and its dealer that sets the dealer's minimum retail price constitutes a per se violation of Section 1 of the Sherman Act, 15 U.S.C. 1, or is instead properly analyzed under the rule of reason. The Court's resolution of that question may affect both federal antitrust enforcement and the extent to which private enforcement of the antitrust laws achieves its intended purpose.

STATEMENT

1. Petitioner manufactures women's accessories, including handbags, shoes, and jewelry, that are sold through retailers under the Brighton brand. Pet. App. 2a, 19a n.1. In 1997, petitioner instituted the "Brighton Retail Pricing and Promotion Policy," under which it would sell its products to only those retailers that followed its suggested resale prices. Subsequently, as part of a new marketing initiative, petitioner insisted that its retailers pledge to comply with petitioner's pricing policy in order to become a Brighton Heart Store. *Id.* at 2a.

Respondent is a retailer of Brighton products. After learning that respondent had discounted its entire line of Brighton products, petitioner suspended all shipment of its products to respondent. "As a result, [respondent's] sales and profits decreased substantially." Pet. App. 3a.

Respondent filed the instant suit, alleging that petitioner had "entered into illegal agreements with retailers to fix Brighton products' prices and terminated [respondent] as a result of those agreements," in violation of the Sherman Act, 15 U.S.C. 1. Pet. App. 3a. Petitioner sought to introduce into evidence the report of its expert economist, Professor Kenneth Elzinga, who concluded that petitioner's "business model, including its use of Suggested Retail Prices, is procompetitive." *Id.* at 18a, 20a. Relying on this Court's decision in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911) (*Dr. Miles*), the district court excluded Professor Elzinga's report on the ground that "[v]ertical minimum price fixing agreements * * * remain per se unlawful." Mem. Op. and Order 4 (Mar. 25, 2004). The jury found petitioner liable and awarded damages of $1.2 million. Pet. App. 7a.

2. The court of appeals affirmed. Pet. App. 1a-11a. Petitioner did not challenge the jury's finding that it had entered into an agreement to fix the minimum price at which its dealers would sell its products, but rather challenged the application of a per se rule to its conduct. *Id.* at 3a. The court of appeals rejected petitioner's contention, concluding that it "remain[ed] bound by [this Court's] holding in *Dr. Miles*." *Id.* at 4a. The court of appeals also found that the trial court had properly excluded Professor's Elzinga's report. The court explained that "[w]ith the *per se* rule, expert testimony regarding economic conditions and the pricing policy's pro-competitive effects is *not* relevant." *Id.* at 5a-6a.

SUMMARY OF THE ARGUMENT

The per se rule against vertical minimum resale price maintenance (RPM) established in *Dr. Miles* is irreconcilable with this Court's modern antitrust jurisprudence and cannot withstand analysis. That per se rule should be abandoned, and *Dr. Miles* should be overruled.

A. This Court's antitrust decisions make clear that the presumptive standard for assessing the legality of challenged conduct is the rule of reason, which examines the reasonableness of a given restraint in the context of a particular case. Per se condemnation of economic restraints under Section 1 of the Sherman Act, 15 U.S.C. 1, is thus exceptional, and is reserved for restraints that always, or almost always, reduce consumer welfare by limiting competition and output. Per se treatment is inappropriate when the economic impact of the type of conduct at issue is not obviously and predictably anticompetitive.

B. Because the effects of RPM can be either anticompetitive or procompetitive depending on the facts in

a given case, a per se rule is clearly inappropriate. There is a widespread consensus of opinion that RPM, like non-price vertical restraints, can have a variety of procompetitive effects that enhance consumer welfare. By reducing *intra*brand competition, RPM can stimulate *inter*brand competition by giving retailers incentives to promote the manufacturer's brand in ways that are desirable for both consumers and the manufacturer. RPM may ensure sufficient margins and incentives for retailers to engage in beneficial point-of-sale services, because it prevents "free riding" by price-cutting dealers that would otherwise make it unprofitable for retailers to incur the cost of providing those services. That potential is magnified by the advent of high-volume Internet retailers. Even absent free riding, RPM may give retailers economic incentives to make additional non-price sales efforts, such as investing in attractive stores and locations or stocking greater quantities of a product in the face of uncertain consumer demand. And, at least for some products, RPM may also serve the manufacturer's interest in preserving brand reputation and consumer loyalty.

C. The reasons suggested for continuation of a per se rule are unpersuasive. The decision in *Dr. Miles* is premised on outdated rationales and principles that have been undermined by subsequent decisions of this Court and cannot withstand modern economic analysis. Common law concerns about restraints on alienation are not relevant to whether a practice is so likely to be anticompetitive as to warrant per se condemnation. Moreover, the belief expressed in *Dr. Miles* that RPM is the functional equivalent of a price-fixing agreement among dealers comports with neither fact nor logic; manufacturers are typically the source of RPM require-

ments, yet they have no economic incentive to enrich dealers with supra-competitive profits while reducing their own sales.

To be sure, RPM limits intrabrand price competition and in some circumstances can harm consumer welfare by supporting cartel efforts by manufacturers or dealers. But non-price vertical restraints can also harm consumer welfare, yet they are subject to the rule of reason. *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977). Nor is there any basis for presuming that RPM will always or almost always support cartel efforts. Likewise, indirect indication of past congressional support for the per se rule of *Dr. Miles* does not counsel against this Court's revisiting the issue in light of subsequent decisions and modern economic analysis.

D. The principle of stare decisis does not justify reaffirmation of *Dr. Miles*. That principle has less force in the antitrust context, because Congress expected this Court to give continuing shape to the meaning of the antitrust laws in keeping with "changed circumstances and the lessons of accumulated experience." *State Oil Co.* v. *Khan*, 522 U.S. 3, 20 (1997). That is particularly true with respect to decisions applying the per se rule, rather than the rule of reason, because that choice is based on experience and economic analysis of particular economic behavior. If experience or economic analysis points in a different direction over time, there is no basis for maintaining a clearly outdated rule. This Court thus has overruled per se prohibitions against non-price vertical restraints and maximum vertical price restraints when "the theoretical underpinnings of those decisions" have been "called into serious question." *Id.* at 21. There is no justification for retaining an anomalous per se ban on

RPM that has no basis in modern antitrust doctrine or experience.

ARGUMENT

THIS COURT SHOULD OVERRULE *DR. MILES* AND SUBJECT RESALE PRICE MAINTENANCE TO THE RULE OF REASON

The decision in *Dr. Miles* was based on reasoning and economic assumptions that predate and conflict with modern economic theory. More importantly, the per se ban on RPM cannot survive subsequent decisions of this Court, which make clear that per se condemnation is appropriate only for those categories of conduct that are manifestly anticompetitive. Thus, in *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the Court overruled the per se prohibition against vertical nonprice agreements established by *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), because such agreements could not be shown to meet the demanding standards for imposition of a per se rule. Similarly, this Court in *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997), overruled the per se ban on vertical maximum price-fixing agreements established by *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1965), in light of subsequent cases and the absence of a sufficient economic justification for a per se rule. Similar considerations compel the conclusion that *Dr. Miles* should be overruled, and that RPM should be evaluated under the same rule-of-reason standard that applies to other vertical agreements.

A. Per Se Condemnation Applies Only To Restraints That Are Almost Invariably Anticompetitive

1. Section 1 of the Sherman Act, 15 U.S.C. 1, declares every "contract, combination * * *, or conspiracy, in

restraint of trade * * * to be illegal." In *Dr. Miles*, this Court declared unlawful vertical agreements between a supplier of patent medicines and the wholesalers and retailers of its products concerning the minimum price at which they resold the supplier's medicines. Subsequent decisions of this Court have read *Dr. Miles* to have established a per se rule under which RPM is unlawful without any inquiry into its competitive effects in a particular case. *NYNEX Corp.* v. *Discon, Inc.*, 525 U.S. 128, 133 (1998); *GTE Sylvania*, 433 U.S. at 51 n.18; *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 733 (1988); *United States* v. *Bausch & Lomb Optical Co.*, 321 U.S. 707, 720 (1944); *United States* v. *Trenton Potteries*, 273 U.S. 392, 401 (1927).

Dr. Miles was decided at the dawn of this Court's antitrust jurisprudence. Subsequent decisions have considerably clarified, and modified, the proper approach to antitrust analysis. In particular, decisions post-dating *Dr. Miles* have made clear that "most antitrust claims are analyzed under a 'rule of reason,'" which requires evaluation of the reasonableness of the challenged restraint in the factual context of a specific case. *Khan*, 522 U.S. at 10; *GTE Sylvania*, 433 U.S. at 49 (observing that the rule of reason is "the prevailing standard.").

By contrast, this Court has concluded that per se condemnation, which obviates the need for proof of the arrangement's effect in a given case, is to be reserved for restraints that are "manifestly anticompetitive," *GTE Sylvania*, 433 U.S. at 49-50, and "would always or almost always tend to restrict competition and decrease output." *Business Elecs.*, 485 U.S. at 723 (quoting *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-290 (1985)). Under modern antitrust principles, therefore, a per se rule is appropri-

ate only for those restraints, such as horizontal price agreements among competitors, that have a "pernicious effect on competition and lack * * * any redeeming virtue." *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958).

2. The determination that a specific practice should be treated as unlawful per se must rest upon experience in analyzing the practice and examining "the actual impact of these arrangements on competition." *White Motor Co.* v. *United States*, 372 U.S. 253, 263 (1963). Any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line-drawing." *GTE Sylvania*, 433 U.S. at 58-59. Per se condemnation is "appropriate '[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (brackets in original (quoting *Arizona* v. *Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982)).

Application of a per se rule embodies a generalization that "certain kinds of agreements will so often prove so harmful to competition and so rarely prove justified that the antitrust laws do not require proof that an agreement of that kind is, in fact, anticompetitive in the particular circumstances." *NYNEX Corp.*, 525 U.S. at 133. "Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them." *GTE Sylvania*, 433 U.S. at 50 n.16. This Court has accordingly been "reluctan[t] to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately

obvious.'" *Khan*, 522 U.S. at 10 (quoting *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458-459 (1986)).

B. Resale Price Maintenance Does Not Meet This Court's Criteria For Application Of A Per Se Rule

This Court has never analyzed the likely economic effects of RPM, much less found that RPM has a predictably "pernicious effect on competition and lack[s] * * * any redeeming virtue." *Northern Pac. Ry.*, 356 U.S. at 5. Because RPM agreements have been unlawful since the *Dr. Miles* decision in 1911, moreover, lower courts have been precluded from considering evidence of the competitive purposes and effects of particular RPM agreements. Thus, the per se prohibition against RPM has never been justified in accordance with the high standards for imposition of per se rules enunciated in *Northern Pacific* and subsequent decisions of this Court. It is clear that RPM falls far short of the current standard for per se condemnation of a practice.

Although RPM may have anticompetitive effects in a particular case, there is no basis "to predict with confidence that the rule of reason will condemn it" because the practice is invariably or almost invariably anticompetitive and lacking in any redeeming social value. *Khan*, 522 U.S. at 10 (quoting *Maricopa Co. Med. Soc'y*, 457 U.S. at 344). To the contrary, there is a widespread consensus that permitting a manufacturer to control the price at which its goods are sold may promote *inter*brand competition and consumer welfare in a variety of ways. Because "the primary purpose of the antitrust laws is to protect interbrand competition," *Khan*, 522 U.S. at 15; *GTE Sylvania*, 433 U.S. at 52 n.19, RPM cannot be classified as a manifestly anticompetitive practice worthy of per se condemnation.

As Justice White observed in his concurring opinion in *GTE Sylvania*, moreover, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). In reality, "the economic effect of * * * unilateral and concerted vertical price setting, agreements on price[,] and nonprice restrictions * * * is in many, but not all, cases similar or identical." *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984). Thus, as Justice White correctly concluded, the Court's decision to subject vertical non-price restraints to the rule of reason in *GTE Sylvania* "necessarily * * * calls[s] into question" application of the per se rule to vertical price restraints generally. 433 U.S. at 70 (White, J., concurring). There is simply no basis for subjecting RPM to per se analysis while analyzing nonprice vertical restraints and maximum resale price maintenance under the rule of reason.

1. RPM will often have procompetitive justifications because it can stimulate interbrand competition

A manufacturer naturally seeks to make additional sales by better serving consumers' interests. Those interests are not limited to low prices, but may include other factors such as access to product demonstration and service; convenience of store hours and location; and knowledgeable, pleasant, and efficient sales personnel. Unless the manufacturer sells directly to consumers, it must rely on its retailers to help it achieve its goals. The interests of retailers and manufacturers, however, do not always coincide. While manufacturers generally benefit from dealer efforts to increase sales by lowering retail

prices, in some circumstances other forms of sales efforts may better serve the interests of both consumers and manufacturers, even if not the dealers.

By fixing the minimum price at which the good may be sold (and thus guaranteeing the retailer a certain margin over the cost of the good to the retailer), RPM provides retailers with an incentive to expend resources in order to attract additional customers for that product, thereby furthering the manufacturer's competitive goals. RPM thus can have the same types of procompetitive effects recognized in *GTE Sylvania* with respect to nonprice vertical restraints such as exclusive territories. "Resale price maintenance, like other vertical restraints, is typically a response to a supplier's problem of inducing distributors to provide adequate levels of distribution for its products." Section of Antitrust Law, ABA, *Antitrust Law and Economics of Product Distribution*, 58 (2006); Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. L. & Econ. 285, 322-325 (1996) (concluding that RPM challenged by the FTC was most likely employed to increase distribution of the products). In other words, by limiting intrabrand price competition, the manufacturer may induce its distributors to provide promotional services and sales efforts and thereby increase the attractiveness of the product. RPM thus may "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." *GTE Sylvania*, 433 U.S. at 54.

"For example, new manufacturers and manufacturers entering new markets can use [RPM] in order to induce * * * retailers to make the kind of investment of capital and labor that is often required in the distribution of

products unknown to the consumer." *GTE Sylvania*, 433 U.S. at 55; see Pet. App. 36a (Elzinga Report) ("Leegin's pricing policy is designed to induce and incent store-owners and sales personnel to promote the Brighton line, and to enable Leegin to compete with larger department stores offering more prominent brands."). "Established manufacturers can use [RPM] to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their product." *GTE Sylvania*, 433 U.S. at 55.

RPM thus accomplishes directly what nonprice vertical restraints accomplish indirectly. *Business Elecs. Corp.*, 485 U.S. at 727-729; *Monsanto*, 465 U.S. at 762; accord Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 156 (1984) (Easterbrook). As this Court has acknowledged, "all vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that." *Business Elecs.*, 485 U.S. at 728. "In fact, vertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services." *Ibid.* Like other vertical restraints, therefore, RPM has complex competitive effects because of its "simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *GTE Sylvania*, 433 U.S. at 51-52.

2. RPM may reduce retailers' incentives to engage in free riding

"There is a consensus in the economic literature that minimum RPM can, in certain circumstances, remedy a

free-riding problem and thereby increase competition and enhance consumer welfare." Economists Pet. Stage Amici Br. 5 (Economists Br.). The most prominent pro-competitive rationale for RPM is that it may alleviate a free-riding problem when retailers incur costs to promote the manufacturer's brand through point-of-sale services. For example, a manufacturer may want its retailers to provide an in-store demonstration or exhibition of a product's features and selections. Such services may be the best way to educate consumers about the product and to promote sales. As is the case with vertical non-price restraints, see *GTE Sylvania*, 433 U.S. at 55, however, an individual retailer has an incentive to free ride on the provision of those services by rival retailers. A retailer offering no services but a lower price can sell to consumers who have been educated by retailers that do provide the services desired by the manufacturer and the consumer. The problem is exacerbated by catalog retailing and the advent of the Internet, as consumers may visit traditional, brick-and-mortar retailers to examine a product and select its features but then purchase the product at a discounted price from a catalog or on-line retailer, whose very lack of "bricks and mortar" affords point-of-sale services impossible and whose lack of expenses for bricks and mortar gives them a competitive advantage over traditional retailers who provide the services that some manufacturers desire.

If free riding is extensive, few if any retailers will incur the costs necessary to provide the services for product promotion, and consumers will not be educated about the manufacturer's product, "despite the fact that each retailer's benefit would be greater if all provided the services than if none did." *GTE Sylvania*, 422 U.S. at 55; accord *Business Elecs.*, 485 U.S. at 731; *Monsanto*,

465 U.S. at 762. RPM reduces or eliminates the incentive to free ride by eliminating the opportunity to attract customers through price cutting. Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 89-96 (1960).

Manufacturers similarly may rely on RPM to give certain prestige retailers an incentive to stock and promote the manufacturer's product. Prestige retailers have developed reputations for stocking only high quality or especially fashionable products, which may be costly for the retailers to identify. Many customers may evaluate products largely on the basis of the stocking choices made by the prestige retailers—an effect known as quality certification or signaling. Other retailers may seek to sell at a discount the same products stocked by prestige retailers, thereby free riding on the prestige retailers' quality certifications. When quality certification is important to consumers, a manufacturer's best strategy may be to impose RPM, which induces prestige retailers to carry its product when free riding otherwise would make it unprofitable to do so. Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 Antitrust L.J. 59, 65-67 (1994) (Marvel); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346 (1984) (Marvel & McCafferty); Ronald N. Lafferty et al., *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases* 34-35 (FTC 1984); Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 56-62 (FTC 1983) (Overstreet).

3. RPM may promote the sale of the manufacturer's product even absent free riding

Even in the absence of free riding, RPM may help the manufacturer encourage retailers to sell its products vis-a-vis rival brands.[1] By ensuring retailers an adequate margin over the wholesale price of the product, RPM provides retailers with an incentive to make non-price sales efforts that attract customers away from other brands. Such sales efforts extend beyond product exhibition and demonstration, on which other retailers can free ride, and include such factors as the attractiveness and location of retail stores and the speed and efficiency with which retailers complete customer transactions, factors that do not lend themselves to free riding by other retailers. A retailer can increase its sales either by cutting prices or by increasing sales efforts, but the manufacturer's sales will not increase unless the retailer takes steps to take sales from rival brands. Manufacturers can give retailers an incentive to compete harder against rival brands by using RPM to ensure that retailers compete in non-price areas and can make a profit while providing the manufacturer's desired level of sales efforts. Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 55, 67-69, 72-73 (1998); Ralph A. Winter, *Vertical*

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[1] It is always in the interest of the manufacturer to make its product attractive to consumers, and controlling retailer discounting may be seen as an important component of a strategy to do so. Petitioner explains that "it was [petitioner's] view that the typical retail strategy of putting products on and off 'sale' degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment." Pet. 3. In addition, price may be associated with a brand's reputation and identity.

Control and Price Versus Nonprice Competition, 108 Q.J. Econ. 61 (1993).

RPM also may encourage retailers to stock the product at the manufacturer's desired level when uncertainties in consumer demand could otherwise limit the quantity purchased by the retailer. Although retailers typically charge high prices to consumers when demand is strong and low prices when demand is weak, under certain circumstances, RPM may cause retailers to charge lower prices than they otherwise would when demand is strong because RPM limits the retailers' losses when demand is weak. Thus, RPM may induce retailers to carry larger inventories, benefitting both the manufacturer and consumers by assuring the continuous availability of the brand to consumers. Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996).

C. The Various Justifications That Have Been Offered For The Per Se Ban On RPM Do Not Withstand Scrutiny

1. Dr. Miles's *reasoning has been thoroughly undermined by this Court's precedents*

a. In rejecting the manufacturer's claim that it was entitled to control the price at which its goods would be sold, *Dr. Miles* relied on the common law proposition that "a general restraint upon alienation is ordinarily invalid." 220 U.S. at 404. In *Business Electronics*, 485 U.S. at 733, this Court described *Dr. Miles*'s per se rule as "based largely on the perception that [a RPM] agreement was categorically impermissible at common law" as "an unlawful restraint on alienation."

As this Court observed in *GTE Sylvania*, however, the common law notion disfavoring restraints on alienation has been subjected to near-universal criticism by antitrust commentators. 433 U.S. at 53 n.21. While that common-law rule may have had resonance with the *Lochner*-era Court, it has limited utility in interpreting the antitrust statutes. The *GTE Sylvania* Court refused to rely on that "ancient rule," holding instead that "the state of the common law 400 or even 100 years ago is irrelevant" to modern antitrust analysis. *Ibid.* (quoting *Arnold, Schwinn & Co.*, 388 U.S. at 392 (Stewart, J., dissenting)). Accordingly, the principal rationale relied upon by the *Dr. Miles* decision is invalid, and cannot justify continued maintenance of the per se ban on RPM.

In *Simpson* v. *Union Oil Co.*, 377 U.S. 13, 16 (1964), the Court identified a closely related rationale for the *Dr. Miles* rule, stating that RPM injured commerce because it was "depriving independent dealers of the exercise of free judgment" in selling the product at a price determined by the dealer. But, of course, dealers remain free to exercise their judgment in deciding to enter a contractual relationship with a supplier. Equally important, the suppliers who perceive significant benefits from controlling retail prices retain the freedom to terminate non-complying dealers, see *United States* v. *Colgate & Co.*, 250 U.S. 300, 306-307 (1919), or even to enter the retail market themselves and eliminate the independent retailers (and their free judgment) altogether. For that reason, the Court held in *Khan*, 522 U.S. at 16, that "interfere[nce] with dealer freedom" could not support a per se ban on vertical maximum price fixing. Thus, the goal of protecting "dealer freedom" cannot support the continued application of the per se prohibition against RPM. And in any event, "impairment

of dealer freedom alone is not sufficient to constitute an unreasonable restraint of trade." 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1609, at 114-115 (2d ed. 2004); see *GTE Sylvania*, 433 U.S. at 53 n.21.

b. The Court in *Dr. Miles* also expressed the view that greater profits from RPM would benefit the dealers, not the manufacturer, and the Court reasoned that RPM would be equivalent to a price-fixing agreement among dealers. 220 U.S. at 407-408. But RPM generally emanates from the *manufacturer*, who has no economic incentive to encourage supra-competitive prices by its dealers. Quite to the contrary, a price-fixing conspiracy at the retail level presumably would reduce quantities sold and thereby reduce the manufacturer's profits. Richard A. Posner, *Antitrust Law* 177 (2d ed. 2001); Robert H. Bork, *The Antitrust Paradox*, 33, 288-290 (1978); see *GTE Sylvania*, 433 U.S. at 56 n.24 ("Generally a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenue.") (quoting Recent Case, *Antitrust Laws—Sherman Act—Vertical Restraints: Enforcement of Resale Location Restrictions is a Per Se Violation of Section One of the Sherman Act*, 88 Harv. L. Rev. 636, 641 (1975)). As Justice Holmes' dissenting opinion in *Dr. Miles* pointed out, the manufacturer is in the best position to determine "what will enable it to do the best business." 220 U.S. at 412.

2. The remaining proffered justifications for the per se rule do not support its retention

a. In *GTE Sylvania*, the Court suggested possible reasons that could justify the continued per se illegality of RPM and distinguish RPM from nonprice vertical restraints. 433 U.S. at 51 n.18. None of the concerns ex-

pressed in *GTE Sylvania* justifies the continued characterization of RPM as a per se offense.

First, the Court noted Justice Brennan's earlier assertion in his concurring opinion in *White Motor Co.*, 372 U.S. at 268, that, unlike vertical nonprice restraints, RPM "almost invariably" reduces interbrand competition. But Justice Brennan did not identify any theoretical explanation or empirical support for that assertion, and the intervening years have not filled either void. To the contrary, as the Court recognized in *GTE Sylvania* itself, the impact of vertical restraints is generally *constrained* by interbrand competition: "when interbrand competition exists, * * * it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." 433 U.S. at 52 n.19. And if a manufacturer does possess interbrand market power, it is not likely to use RPM as a way to raise resale prices; if elevation of resale price were the manufacturer's ultimate purpose, the manufacturer could simply raise its own price to the distributor and thereby keep for itself any higher revenues resulting from the higher price.

Economists have observed, moreover, that nonprice vertical restraints, such as exclusive territories, can more completely restrict intrabrand competition than does RPM. While exclusive territorial restrictions can eliminate virtually all intrabrand competition, RPM permits retailers to engage in intrabrand competition on factors other than price, "leav[ing] multiple sellers of the brand in the same geographic market to engage in interbrand competition." Economist Br. 17; Richard A. Posner, *The Next Step in Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 9 (1981) ("Resale price maintenance is more flexible than

exclusive territories as a method of limiting price competition among dealers.").

Second, the Court in *GTE Sylvania* noted that RPM may facilitate cartelization. 433 U.S. at 51 n.18.[2] That possibility is a reason to subject RPM to the rule of reason. However, there is no basis in evidence or experience to predict that RPM "would always or almost always" be condemned under that standard. *Business Elecs.*, 485 U.S. at 723 (quoting *Northwest Wholesale Stationers, Inc.*, 472 U.S. at 289). Studies of RPM cases over many years have found relatively few instances of such anticompetitive uses of RPM. An analysis of all litigated RPM cases during 1976-1982 concluded that "collusion theories do not seem capable of explaining at least 85 percent of the cases." Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 292 (1991).[3] In any event, all cartel agreements are illegal per se, regardless

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[2] Manufacturers could use RPM, particularly when combined with exclusive dealing arrangements with their retailers, to facilitate a price-fixing conspiracy by enhancing their ability to detect departures from agreed-upon prices. In addition, retailers might act collectively to coerce a manufacturer to institute RPM as a means of thwarting competition from a discounting retail competitor. *Business Elecs.*, 485 U.S. at 725-726; Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & Econ. 363, 365-369, 373-378 (1985); Overstreet 13-23.

[3] Another study found that only 7% of the horizontal conspiracy cases filed by the Department of Justice during 1890-1983 involved resale price maintenance. Stanley I. Ornstein, *Resale Price Maintenance and Cartels*, 30 Antitrust Bull. 401, 416-417 (1985). The same study found that only 10% of RPM complaints brought by the FTC during 1942-1983 involved cartels. *Id.* at 423. Still another report found that a "substantial portion of the [FTC]'s RPM enforcement efforts [from 1965-1982] have been concentrated in markets which appear to be structurally competitive." Overstreet 74.

of whether the cartel uses RPM. And the rule of reason would condemn any RPM demonstrated to be a means of supporting a cartel. Cf. *Khan*, 522 U.S. at 22 ("In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct.").

Third, the Court in *GTE Sylvania* also cited past congressional action as indicating congressional "approval of a *per se* analysis of vertical price restrictions." 433 U.S. at 51 n.18. The Court referred to the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, amending 15 U.S.C. 1, 45(a) (1970), which had repealed provisions of earlier statutes which allowed "fair trade" pricing, *i.e.*, RPM, at the option of individual States. Congress subsequently enacted temporary prohibitions, no longer in effect, on the Department of Justice's use of appropriated funds to advocate the overruling of *Dr. Miles*. J. Res of Nov. 14, 1983, Pub. L. No. 98-151, §101(e), 97 Stat. 973; Act of Nov. 28, 1983, Pub. L. No. 98-166, §510, 97 Stat. 1102; Act of Dec. 13, 1985, Pub. L. No. 99-180, §605, 99 Stat. 1169.

Those congressional enactments do not support the continued existence of a rule that is dramatically out of step with this Court's modern antitrust jurisprudence. As an initial matter, there is no incongruity between Congress's action in 1975 and a more flexible treatment of RPM under the Sherman Act. In repealing the broad per se *legality* afforded by the fair trade laws and once again subjecting RPM to antitrust scrutiny, Congress did not mandate a particular standard to govern such scrutiny. Easterbrook 139. Although both the House and Senate reports on the 1975 legislation indicate Congress's awareness of the reality that by repealing the exemption for fair trade laws they were remitting RPM

to the *Dr. Miles* regime, H.R. Rep. No. 341, 94th Cong., 1st Sess. 3 (1975) (House Rep.); S. Rep. No. 466, 94th Cong., 1st Sess. 1-2 (1975), the legislative history suggests that Congress merely intended to end a special exemption from the Federal antitrust laws that allowed States to declare RPM per se *legal*. House Rep. 5.

In repealing the special exemption for RPM provided by the fair trade laws, Congress did not purport to freeze that status and deprive this Court of its recognized authority and flexibility to interpret the Sherman Act's general language in accordance with our growing understanding of commercial realities. Easterbrook 139. There is thus no support for the notion that Congress intended to preserve a per se ban on RPM even if subsequent developments in the law rendered that ban anomalous and markedly inconsistent with the treatment of other forms of vertical restraints. Likewise, the earlier prohibitions against the Department's use of appropriated funds to advocate *Dr. Miles*'s demise have not been in effect for over 20 years, and in any event are hardly a testament to the robustness of the *Dr. Miles* rule. Congress could have buttressed the *Dr. Miles* rule directly, and more to the point, retains the full ability to address RPM legislatively. If *Dr. Miles* cannot survive as a matter of stare decisis, see pp. 24-28, *infra*, it should no longer skew any congressional debate concerning RPM.[4]

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[4] Congressional views about RPM and *Dr. Miles* have varied over the years. The 1975 legislation, after all, repealed earlier legislation, the Miller-Tydings Fair Trade Act, ch. 690, tit. VIII, 50 Stat. 693, and the McGuire Bill, ch. 745, 66 Stat. 631, that had been intended to place "the stamp of approval upon price maintenance transactions under State [fair trade laws], notwithstanding the Sherman Act of 1890." 81 Cong. Rec. 8138 (1937) (statement of Rep. Dirksen).

b. It also has been argued that RPM necessarily harms those customers who are already poised to purchase the manufacturer's product without any special dealer services supported by RPM (so-called "inframarginal" customers). According to that argument, RPM forces inframarginal customers to pay more for a product they would have purchased in any event. William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 990-992 (1985) (Comanor). That argument plainly cannot support per se condemnation. Prices need not go up when RPM causes retailers to provide costly additional services, because the manufacturer, in imposing RPM, may lower its wholesale price to retailers. Marvel 67-71; Marvel & McCafferty 369-373. RPM also may spur greater retail sales efforts that increase total output, allowing the manufacturer to achieve economies of scale.

Second, even if inframarginal customers pay higher prices, other customers receive the benefit of products they find more attractive as a result of the enhanced product information and service. In other words, higher prices resulting from RPM may enhance consumer welfare as a whole because consumers effectively receive a different and better product at the higher price. And third, harm to inframarginal customers will generally be limited as long as interbrand competition exists, "because of the ability of consumers to substitute a different brand of the same product." *GTE Sylvania*, 433 U.S. at 52 n.19.

In any event, the per se prohibition against RPM does not prevent manufacturers from engaging in other conduct that achieves similar results. Prevented from using their preferred—and thus presumably most efficient—

marketing strategy, manufacturers can be expected to adopt the best available alternative to RPM. For example, manufacturers might consider relatively inefficient vertical integration or offer services themselves that could be more efficiently produced by retailers, thereby decreasing consumer welfare. See p. 17, *supra*. Even under the *Dr. Miles* rule, moreover, manufacturers may lawfully adopt a policy of terminating retailers for failure to abide by the manufacturer's suggested retail price, as long as they avoid an agreement. *Colgate & Co.*, 250 U.S. at 306-307. Thus, there is little basis for concern that elimination of the *Dr. Miles* rule will permit RPM that always or almost always harms consumer welfare.

D. Considerations Of Stare Decisis Do Not Justify Retention Of The *Dr. Miles* Rule

1. Although this Court approaches the reconsideration of its prior decisions with the "utmost caution," *Khan*, 522 U.S. at 20, the principle of stare decisis is "not an inexorable command." *Ibid.* (quoting *Payne* v. *Tennessee*, 501 U.S. 808, 828 (1991)). "In the area of antitrust law, there is a competing interest, well represented in [the] Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Ibid.* Accordingly, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act" in light of the accepted view that Congress expected courts to give continuing shape to antitrust law. *Ibid.* That is particularly true in the context of per se rules, which are adopted based on experience and economic analysis and should not survive when experience and economic analysis thoroughly undermine the case for per se treatment.

For those reasons, this Court "has reconsidered its decisions construing the Sherman Act when the theoreti-

cal underpinnings of those decisions are called into serious question." *Khan*, 522 U.S. at 21. In an analogous context, this Court recently overruled its prior decisions establishing a presumption that patents confer market power in the context of a tying case, a presumption that did not comport with modern economic reality. *Illinois Tool Works Inc.* v. *Independent Ink, Inc.*, 126 S. Ct. 1281 (2006). Those decisions reflect this Court's reluctance "to create out of the single term 'restraint of trade' a chronologically schizoid statute, in which a 'rule of reason' evolves with new circumstances and new wisdom, but a line of *per se* illegality remains forever fixed where it was." *Khan*, 522 U.S. at 21. There is similarly no justification for retaining an anomalous per se rule that is based on erroneous reasoning and manifestly does not satisfy this Court's modern test for per se treatment. "With the views underlying [*Dr. Miles*] eroded by this Court's precedent, there is not much of that decision to salvage." *Ibid.*

2. *Dr. Miles*'s per se rule has few, if any, defenders in the scholarly community. See *Khan*, 522 U.S. at 15-18 (relying on scholarly criticism in abrogating per se ban on maximum vertical price restraints). As the brief filed at the petition stage by leading economists aptly summarizes:

> In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue.

Economists Br. 15-16.

Even commentators who emphasize the potential anticompetitive effects of vertical restraints generally endorse some form of rule-of-reason analysis that takes into account the economic and market conditions in any given case. For example, Professor Pitofsky, while generally endorsing *Dr. Miles*'s per se rule, has proposed significant exceptions to the rule in light of modern economic realities. Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1488, 1495 (1983).

Similarly, Professor Comanor, who has proposed a per se ban or a "modified rule of reason analysis" for vertical price and nonprice restraints involving "established products," has advocated that, in the case of new products or products of new market entrants, "the restraints should be permissible, or at least should be treated more leniently in any modified rule of reason analysis." Comanor 99, 1001, 1002. Other critics of RPM are no exception. Robert L. Steiner, *How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 Antitrust L.J. 407, 445, 446-447 (1997) (explaining that in some circumstances "the consumer interest is often better served by RPM [as opposed to other vertical restraints]—contrary to its per se illegality and the rule-of-reason status of vertical nonprice restraints"); Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 Antitrust L.J. 83, 135 (1995) (explaining that a "structured rule of reason should be applied to both price and nonprice [vertical] restraints").[5]

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[5] Grimes suggests that, under a properly structured rule-of-reason analysis, RPM would more frequently be found anticompetitive than

3. Continuation of a per se ban on RPM poses significant practical risks to the procompetitive purposes of the antitrust laws. Most saliently, the per se ban on RPM prohibits conduct that would often be efficiency-enhancing and beneficial, with the result that overall economic welfare is reduced. See pp. 9-16, *supra*. Perpetuation of unjustified per se rules also risks undermining the value of per se rules more generally. Per se rules are essential to effective enforcement of the antitrust laws. They establish bright-line tests that identify plainly pernicious conduct, thereby deterring unlawful behavior and providing clear guidance to the business community and antitrust counselors. If a per se rule, once adopted, were to be treated as sacrosanct, it could make courts overly cautious in adopting such rules. Moreover, courts, agencies, and the business community should have confidence that per se rules are applied only to manifestly anticompetitive conduct. Application of a per se rule to conduct that often would be procompetitive has the potential to erode the rationale for per se treatment and foster judicial reluctance to use such a blunt instrument even in those circumstances when it is appropriate.

In *Colgate*, *supra*, the Court held that the antitrust laws permit a manufacturer unilaterally to announce that it will refuse to do business with dealers who sell below the manufacturer's suggested retail price, provided that the dealer does not actually enter into an agreement to maintain retail price. But the distinction between unilateral conduct that is lawful under *Colgate* and an implicit agreement that is illegal per se under *Dr. Miles* is "often * * * difficult to apply in practice." *Monsanto*, 465 U.S. at 762. The distinction has spawned considerable con-

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would some other vertical restraints. Grimes, *supra*, at 119-134. He nevertheless rejects a per se rule in favor of the rule of reason.

cern and uncertainty in the business community and the courts, potentially chilling even procompetitive conduct that might qualify as unilateral under *Colgate*. Cf. *GTE Sylvania*, 433 U.S. at 48 n.14 (discussing distinctions made by lower courts to limit *Schwinn*'s per se reach).

4. Nor does the per se rule of *Dr. Miles* comport with this Court's closely related precedents. As discussed, the Court in *GTE Sylvania* and *Khan* overruled its prior decisions imposing a per se ban on other vertical restraints with effects similar to those of RPM. See pp. 6, 9-10, *supra*. The similarity between RPM and other vertical restraints as to which per se treatment has been abandoned makes the continued survival of *Dr. Miles* impossible to justify. In other contexts, the Court has overruled anachronistic precedents that could not be squared with the reasoning of opinions in closely related cases. *E.g. Lapides* v. *Board of Regents of Univ. Sys.*, 535 U.S. 613, 623 (2002); *Ring* v. *Arizona*, 536 U.S. 584, 602-609 (2002). The same result is appropriate here.

* * * * *

The time has come to harmonize the law's treatment of RPM with modern antitrust doctrine. There is no sound basis for treating RPM differently from other vertical agreements. The rule of reason offers protection against anticompetitive uses of RPM, while allowing defendants to defend their arrangements as legitimate and procompetitive. Moreover, analyzing RPM under the same standards that govern other vertical restraints will avoid the continued necessity to make tenuous distinctions between economically indistinguishable conduct and will promote proper application of the per se rule, to the benefit of strong antitrust enforcement and a vigorously competitive economy.

CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded for further proceedings.

Respectfully submitted.

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JANUARY 2007

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No. 06-480

In The

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC. DBA KAY'S KLOSET . . . KAY'S SHOES,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF THE AMERICAN ANTITRUST INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE*

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SUMMARY OF ARGUMENT

The issue before the Court is whether petitioner or its *amici* have offered a sufficiently compelling reason for overruling the venerable *Dr. Miles* per se rule against minimum resale price maintenance (RPM) in light of Congress's ratification of the rule. They have not. According to petitioner and its *amici*, the main cost of *Dr. Miles* is that manufacturers that wish to adopt RPM for a legitimate purpose (e.g., promotion of services) are forced to use alternative means to achieve that end (e.g., direct payments). But even assuming *arguendo* that RPM can have procompetitive uses in theory, petitioner and its *amici* have offered no evidence that such uses are common or important or that less restrictive alternatives are in fact more costly or less effective. Nor have they indicated the magnitude of any such costs, and there is no reason to think that such costs are significant.

In contrast to the theoretical case offered by proponents for a radical shift in antitrust policy, the reality is that RPM virtually always raises prices to consumers,

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[1] The written consents of all parties to the filing of this brief have been lodged with the Clerk. No counsel for a party has authored this brief in whole or in part, and no person or entity other than AAI or its counsel has made a monetary contribution to the preparation or submission of this brief. The AAI is managed by its Board of Directors, which has approved of this filing. The individual views of members of the Advisory Board may differ from the positions taken by AAI.

prevents more efficient retailers from passing along the savings from their efficiency to consumers, tends to retard innovation in retailing, and often has been used by retailers and manufacturers for anticompetitive ends. Repealing *Dr. Miles* would increase the incidence of anticompetitive RPM and increase business uncertainty. Thus, the conceptual basis of the per se rule remains sound. The distinction between price and nonprice restraints is also valid because nonprice restraints are less likely to impair interbrand competition at the retailer and manufacturer levels and more likely to have procompetitive benefits. In sum, not only is there no compelling basis for reversing *Dr. Miles*, but consumer welfare is better served by a per se rule than a rule of reason, as most antitrust jurisdictions in the world recognize by treating RPM harshly.

I. PETITIONER AND ITS *AMICI* OFFER NO COMPELLING JUSTIFICATION FOR OVERRULING *DR. MILES*

A. *Dr. Miles* Is Firmly Embedded In This Court's Antitrust Jurisprudence And Has Been Ratified By Congress

For nearly a century since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), this Court has repeatedly and unequivocally held that minimum RPM is per se illegal. Even as the Court has altered the treatment of nonprice vertical restraints in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), adjusted the contours of the *Colgate* doctrine in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), clarified the boundary between price and nonprice restraints in *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717 (1988), and changed the treatment of maximum RPM in *State Oil Co. v. Khan*, 522 U.S. 3 (1997), it has steadfastly adhered to the core of *Dr. Miles*, significantly in respect of the will of Congress. Since 1975, Congress has repeatedly and unequivocally acted to extend and preserve

Dr. Miles.[2] "With the possible exception of merger policy, there is probably no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts and enforcement agencies as the area of resale price maintenance ('RPM')." H.R. Rep. No. 237, 102nd Cong., 1st Sess. 4 (1991).

Contrary to the arguments of petitioner and the United States, the Court in *Sylvania* did not err when it read the repeal of the fair trade amendments as approval of *Dr. Miles*.[3] The legislative history of the Consumer Goods Pricing Act of 1975 indicates not merely "Congress's awareness of the reality that by repealing the exemption for fair trade laws [it] was remitting RPM to the *Dr. Miles* regime," Brief for the U.S. as Amicus Curiae (U.S. Br.) 21-22, but that Congress specifically intended to outlaw the practice of RPM by restoring *Dr. Miles* as the governing law nationwide. At the hearings, enforcement agency officials testified that RPM was pernicious and should be banned.[4] The committee reports show that the House and

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[2] *See* Consumer Goods Pricing Act of 1975, Pub. L. No. 94-175, 89 Stat. 801. After the Reagan Administration's Justice Department sought to overturn *Dr. Miles* in *Monsanto*, Congress passed appropriations measures in 1983, 1985, 1986, and 1987 preventing the Department from using appropriated funds for this purpose. Such measures were no longer needed when the (first) Bush Administration came to office and promised to enforce *Dr. Miles*. *See Speech by Ass't Attorney General James F. Rill*, 57 Antitrust & Trade Reg. Rep. (BNA) 671, Nov. 9, 1989 (stating that the Antitrust Division would not advocate change to the per se rule and would "not hesitate to bring a resale price maintenance case, contingent only on evidence sufficient to establish a genuine resale price conspiracy and facts showing a significant regional impact").

[3] *See* Herbert Hovenkamp, *Chicago and its Alternatives*, 1986 Duke L.J. 1014, 1020 n.34 ("I am persuaded . . . that Congress has sanctioned the per se rule for resale price maintenance, and that we should feel obliged to comply with it until Congress tells us otherwise.").

[4] *See* Fair Trade Laws: Hearings on S. 408 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess. 170-72 (1975) (Senate Hearings) (FTC Chairman Lewis A. Engman testifying that "fair trade laws are little more than anti-competitive price fixing, unadorned with any redeeming features"); *id.* at 172-77 (Thomas E. Kauper, Ass't Attorney General, making

(Continued on following page)

Senate Judiciary Committees intended to remove the fair trade obstacle to the per se treatment of RPM.[5] And the chief sponsors of the bill articulated the same understanding.[6] Congress was well aware of the theoretical procompetitive uses of RPM, including the promotion of dealer services, yet rejected any exceptions to the per se rule.[7]

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strong case against "resale price fixing" in any circumstances); Fair Trade: Hearings on H.R. 2384 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 94th Cong., 1st Sess. 109, 121 (1975) (House Hearings) (similar testimony of Keith Clearwaters, Deputy Ass't Attorney General).

[5] S. Rep. No. 466, 94th Cong., 1st Sess. 1 (1975) (Senate Rep.) ("The purpose of the proposed legislation is to repeal Federal antitrust exemptions which permit States to enact fair trade laws [which are] legalized price-fixing ... Without these exemptions the agreements they authorize would violate the antitrust laws."); *id.* at 2 (repeal "will prohibit manufacturers from enforcing resale prices."); H.R. Rep. No. 341, 94th Cong., 1st Sess. 2 (1975) (House Rep.) ("An agreement between a manufacturer and a retailer that the retailer will not resell the manufactured product below a specified price is ... *per se* illegal under section 1 of the Sherman Act").

[6] *See* 121 Cong. Rec. 38,049-50 (1975) (Sen. Brooke, chief Senate sponsor: "Fair trade is legalized price fixing.... Without [Miller-Tydings and McGuire Acts], these interstate-price fixing conspiracies would be in violation of ... the Sherman Antitrust Act"); *id.* at 23,659 (Rep. Jordan, chief House sponsor: without the exemptions RPM agreements "would be per se violations of the antitrust laws"); *see also* Statement by President Gerald R. Ford Upon Signing the Consumer Goods Pricing Act of 1975 (law "will make it illegal for manufacturers to fix the prices of consumer products sold by retailers").

[7] The Senate report rejected the dealer services case for RPM as follows: "Opponents were primarily service-oriented manufacturers who claimed retailers would not give adequate service unless they were guaranteed a good margin of profit. However, the manufacturer could solve this problem by placing a clause in the distributorship contract requiring the retailer to maintain adequate service. Moreover, the manufacturer has the right to select distributors who are likely to emphasize service." Senate Rep. 3; *see also* House Rep. 4 ("[T]o the extent that ... the retailer charges a higher price because he is providing more services to his customers, consumers should have the freedom to choose between paying more for those services and buying nothing but the unadorned product at a lower price from a competitor."); *id.* at 5

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B. The Court Has Set A Very High Bar For Overruling A Long-Standing Statutory Construction Ratified By Congress

"*[S]tare decisis* is a basic self-governing principle within the Judicial Branch, which is entrusted with the sensitive and difficult task of fashioning and preserving a jurisprudential system that is not based upon 'an arbitrary discretion.'" *Patterson v. McLean Credit Union*, 491 U.S. 164, 171 (1989) (quoting The Federalist, No. 78, A. Hamilton). The Court has long held that "considerations of *stare decisis* weigh heavily in the area of statutory construction, where Congress is free to change this Court's interpretation of legislation." *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977). As Justice Brandeis observed, and this Court has repeatedly quoted: "*Stare decisis* is usually the wise policy because in most matters, it is more important that the applicable rule of law be settled than that it be settled right. This is commonly true even where the error is a matter of serious concern, provided correction can be had by legislation." *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (dissenting). Accordingly, as Justice Kennedy explained in a statutory case, this Court "will not depart from the doctrine of *stare decisis* without some compelling justification." *Hilton v. S. Carolina Public Ry. Com'n*, 502 U.S. 197, 202 (1991).

The "strong presumption of continued validity that adheres in the judicial interpretation of a statute" applies to cases interpreting the Sherman Act. *Square D Co. v. Niagra Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986) (declining to overrule *Keogh* doctrine); *see also Illinois Brick*, 431 U.S. at 736-37 (declining to overrule *Hanover Shoe* rule); *Flood v. Kuhn*, 407 U.S. 258, 282-84 (1972) (refusing to overturn prior decisions exempting baseball from the Sherman Act notwithstanding "any inconsistency or illogic in all this" because the "aberration

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(rejecting "new product" exemption); *see also* House Hearings 32 (quoting Bork's efficiency explanation for RPM).

. . . has been with us now for half a century" and Congress "has clearly evinced a desire not to disapprove them legislatively.").

The case for following precedent here is particularly strong because not only has Congress repeatedly acted in this area, its actions could not more clearly validate *Dr. Miles*. By eliminating the fair trade exceptions to *Dr. Miles* that it had written into Section 1, Congress essentially reenacted the law prior to Miller-Tydings, i.e. the law of *Dr. Miles*.[8] To be sure, in *Khan* the Court stated that "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition." 522 U.S. at 20-21 (internal quotes omitted). But even if this is correct,[9] the

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[8] *See United States v. Board of Comm'rs*, 435 U.S. 110, 134-35 (1978) ("When a Congress that re-enacts a statute voices its approval of an administrative or other interpretation thereof, Congress is treated as having adopted that interpretation, and this Court is bound thereby."); *see also Hubbard v. United States*, 514 U.S. 695, 714 (1995) ("*Stare decisis* has special force when legislators or citizens have acted in reliance on a previous decision") (internal quotes omitted).

[9] Scholars have questioned the extent to which the Court operates as a "free agent" in interpreting the Sherman Act. For a recent critique, *see* Daniel A. Farber & Brett H. McDonnell, *"Is There a Text in this Class?" The Conflict Between Textualism and Antitrust*, 14 J. Contemp. Leg. Issues 619 (2005). In any event, Justice O'Connor's statement that the presumption of validity of statutory precedent is weaker in Sherman Act cases was unsupported and in fact a departure from the Court's decisions in *Square D, Illinois Brick*, and *Flood*. *But see Guardians Ass'n v. Civ. Serv. Com'n*, 463 U.S. 582, 642 n.12 (1983) (Stevens, J., dissenting). Indeed *Illinois Brick* is a leading cite for the "super-strong" presumption of the correctness of statutory precedents. *See* William N. Eskridge, Jr., *Overruling Statutory Precedents*, 76 Geo. L. J. 1361, 1368 n.34 (1988). Nor does it follow that the "common law" nature of Sherman Act interpretation should give the Court more leeway to reverse a long-standing precedent. Indeed, the Court in *Maricopa* thought the opposite:

> Our adherence to the *per se* rule [for maximum horizontal price fixing] is grounded not only on economic prediction,

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Court has never suggested that the "strong presumption" of continued statutory validity has any less force with respect to the Sherman Act than other statutes when Congress has legislated in the area in reliance on the Sherman Act precedent and made its intent absolutely clear. *See Square D*, 476 U.S. at 424 ("We are especially reluctant to reject this presumption in an area that has seen careful, intense, and sustained congressional attention.").

C. Congressional Reliance Distinguishes This Case From Other Sherman Act Cases In Which *Stare Decisis* Was Not Decisive

None of the Sherman Act cases in which the Court has overruled one of its precedents has involved any congressional reliance on the precedent. In *Sylvania*, the Court expressly noted that while "Congress recently has expressed its approval of a *per se* analysis of vertical price restrictions by repealing those provisions of the Miller-Tydings and McGuire Acts allowing fair trade pricing at the option of the individual States," "[n]o similar expression of congressional intent exists for nonprice restrictions." 433 U.S. at 51 n.18 (1977). In *Khan*, the Court could "infer little meaning from the fact that Congress has not reacted legislatively to *Albrecht*," and "[i]n any event, the history of various legislative proposals regarding price

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> judicial convenience, and business certainty, but also on a recognition of the respective roles of the Judiciary and the Congress in regulating the economy. . . . Given its generality, our enforcement of the Sherman Act has required the Court to provide much of its substantive content. By articulating the rules of law with some clarity and by adhering to rules that are justified in their general application, however, we enhance the legislative prerogative to amend the law. . . .

Arizona v. Maricopa County Med. Soc'y, 457 U.S. 332, 354-55 (1982). *See also* Lawrence C. Marshall, *"Let Congress Do It": The Case for an Absolute Rule of Statutory Stare Decisis*, 88 Mich. L. Rev. 177, 223 (1989) (arguing that case for statutory *stare decisis* for common law-like statutes is *stronger* than for other statutes because "the lawmaking role of the court is at its pinnacle").

fixing seems neither clearly to support or denounce the *per se* rule of *Albrecht*." 522 U.S. at 19.[10]

In *Copperweld Corp. v. Ind. Tube Corp.*, 467 U.S. 752 (1984), there was no suggestion that Congress (or anyone else) had acted in reliance on the intra-enterprise conspiracy doctrine, nor any hint that Congress approved the doctrine. And in *Illinois Tool Works Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281 (2006), the Court reversed the presumption of market power in patent tying antitrust cases precisely because Congress had made such a change in patent misuse cases. Thus, the Court was acting in deference to congressional will, not against it. *See id.* at 1290-91 ("While the 1988 amendment does not expressly refer to the antitrust laws, it certainly invites reappraisal of the *per se* rule announced in *International Salt*.").

In contrast, in *Square D*, where congressional reliance was strong, the Court declined to overrule *Keogh v. Chicago & N.W. Ry. Co.*, 260 U.S. 156 (1922), which barred treble damage actions to remedy price fixing conspiracies in connection with filed rates. As here, the United States as *amicus curiae* urged that *Keogh* be overruled because the rationales of the decision had been undermined by subsequent developments and rendered the "decision obsolete and its continued application anomalous."[11] Judge

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[10] The Consumer Goods Pricing Act of 1975 repealing the fair trade exemptions was not directed at maximum RPM. *See* Brief for the U.S. and F.T.C. as Amici Curiae Supporting Reversal, *State Oil Co. v. Kahn*, 1997 WL 163852 *18 n.7 (U.S. *Khan* Br.) (noting that the "congressional approval of per se analysis inferred by the Court [in *Sylvania*] from repeal of the federal antitrust exemptions for state 'fair trade' laws would not extend to maximum price restraints, because the sort of 'fair-trade pricing' . . . covered by those laws . . . typically involved only the setting of minimum prices.").

[11] Brief for the U.S. as Amicus Curiae Supporting Petitioners, 1985 WL 670055 (U.S.) *7. And, as here, the United States argued that congressional action in the area did not indicate that Congress "intended to fix by legislative fiat the balance this Court struck in 1922" particularly in light of the "long tradition of dialogue between the judicial and legislative branches that has served to perfect and preserve the vitality of the antitrust laws." *Id.* at *16 & n.21. The United States

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Friendly, writing for the Second Circuit also thought that the reasoning of *Keogh* "outdated" and that "[t]he case for reaching a conclusion contrary . . . is particularly strong in the light of recent statutes which rely increasingly on competition rather than regulation to insure the reasonableness of rail and motor carrier rates." 760 F.2d 1347, 1349, 1354 (2d Cir. 1985). The Supreme Court essentially agreed, but nonetheless declined to overrule *Keogh*, stating:

> Even if it is true that these developments cast Justice Brandeis' reasons in a different light, however, it is also true that the *Keogh* rule has been an established guidepost at the intersection of the antitrust and interstate commerce statutory regimes for some 6 1/2 decades. *The emergence of subsequent procedural and judicial developments does not minimize* Keogh's *role as an essential element of the settled legal context in which Congress has repeatedly acted in this area.*

476 U.S. at 423 (emphasis added). The Court concluded, "If there is to be an overruling of the *Keogh* rule, it must come from Congress, rather than this Court." *Id.* at 424.

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Petitioner and its *amici* fail to come to grips with the implications of congressional action on the *stare decisis* question, treating them as independent issues. Thus, having established that congressional action does not *mandate* the per se rule, the United States goes on to suggest that *stare decisis* does not justify retention of *Dr. Miles* because it is bad policy and does not comport with *Sylvania's* treatment of nonprice restraints (even though the Court in *Sylvania* thought different treatment was appropriate). But the point is that congressional approval bolsters the case for *stare decisis* such that only the most compelling reasons can justify reversal. The United States asserts, "Congress could have buttressed the *Dr. Miles* rule

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also emphasized the fact that the *Keogh* rule was a "judicially-crafted immunity," *id.*, thus suggesting that the Court had ample leeway to reverse course.

directly, and more to the point, retains the full ability to address RPM legislatively. If *Dr. Miles* cannot survive as a matter of *stare decisis* . . . it should no longer skew any congressional debate concerning RPM." Br. 22. This is exactly backwards. The doctrine of *stare decisis* in statutory cases ensures that congressional authority to amend the law is preserved. *See Maricopa*, 457 U.S. at 354; *see also Neal v. U.S.*, 516 U.S. 284, 295-96 (1996) ("Were we to alter our statutory interpretations from case to case, Congress would have less reason to exercise its responsibility to correct statutes that are thought unwise or unfair.").

D. Federal And State Enforcers Continue to Rely On The Per Se Rule To Bring Cases Against Vertical Price Fixing And Related Conduct

In reversing *Albrecht*, the Court in *Khan* relied in part on the fact that "*Albrecht* has little or no relevance to ongoing enforcement of the Sherman Act." 522 U.S. at 18; *see also Copperweld*, 476 U.S. at 777 & n.25; *Hubbard*, 514 U.S. at 713. In contrast, the Justice Department, FTC, and the States continue to rely on *Dr. Miles* to bring cases against RPM and related conduct.[12] Moreover, the federal

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[12] Recent FTC cases include: *In re Nintendo of America Inc.*, 114 F.T.C. 702 (1991), *In re Kreepy Krauly USA, Inc.*, 114 F.T.C. 777 (1991), *In re The Keds Corp.*, 117 F.T.C. 389 (1994), *In re Reebok International, Ltd.*, 120 F.T.C. 20 (1995), *FTC v. Onkyo U.S.A. Corp.*, 1995-2 Trade Cas. (CCH) ¶71,111 (D.D.C. 1995), *In re New Balance Athletic Shoe, Inc.*, 122 F.T.C. 137 (1996), *In re American Cyanamid Corp.*, 123 F.T.C. 1257 (1997), *In re Nine West Group, Inc.*, 2000 FTC LEXIS 48 (2000), and *In re Time Warner, Inc.*, 2000 FTC LEXIS 40 (2000) (minimum advertised price agreement). DOJ cases include: *U.S. v. Canstar Sports USA, Inc.*, 1993-2 Trade Cas. (CCH) ¶70,372 (D. Vt. 1993), *U.S. v. California SunCare, Inc.*, 1994-2 Trade Cas. (CCH) ¶70,843 (C.D. Cal. 1994), *U.S. v. Playmobil USA, Inc.*, 1995-1 Trade Cas. (CCH) ¶71,000 (D. D.C. 1995), *U.S. v. Anchorshade, Inc.*, 1996-2 Trade Cas. (CCH) ¶71,640 (S.D. Fla. 1996), and *U.S. v. Brush Fibers, Inc.*, 1997-2 Trade Cas. (CCH) ¶71,915 (E.D. Pa. 1997). The numerous cases brought by the States are identified in their *amicus* brief.

and state enforcement agencies, on a bipartisan basis, have invoked the per se rule in their guidelines and enforcement agendas.[13]

II. THE CONCEPTUAL UNDERPINNINGS OF THE PER SE RULE REMAIN SOUND

Petitioner and its *amici* assert that the per se rule is not appropriate for minimum RPM because there is a consensus among economists that RPM can sometimes be procompetitive, and the per se rule is reserved for conduct that is "always" or "almost always" anticompetitive. However, that is not the test that the Court applied in either *Sylvania* or *Khan*. Indeed, the Court in *Sylvania* suggested – and modern decision theory dictates – that the proper focus is not simply on the frequency with which RPM is anticompetitive or procompetitive, but also on the magnitude of the harms or benefits and, given error costs, whether an alternative rule would generally improve consumer welfare and the administration of the antitrust laws. In *Sylvania*, Justice Powell stated:

> *Per se* rules . . . require the Court to make broad generalizations about the social utility of particular commercial practices. The probability that anticompetitive consequences will result from a practice *and the severity of those consequences*

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[13] *See* Dept. of Justice and F.T.C., *Antitrust Guidelines for the Licensing of Intellectual Property* §5.2 (April 6, 1995) ("the Agencies will enforce the per se rule against resale price maintenance in the intellectual property context"); *cf. Illinois Tool Works*, 126 S. Ct. at 1292-93 (finding it significant that Guidelines did not follow presumption of market power in tying cases). It is noteworthy that two of the current FTC commissioners dissented from the FTC's decision to join the *amicus* brief of the United States. *See* An Open Letter to the Supreme Court of the United States from Commissioner Pamela Jones Harbour (Feb. 26, 2007), at http://www.ftc.gov/speeches/harbour.htm. Moreover, prior agency support for *Dr. Miles* has been bipartisan. *See, e.g., Interview With Former Assistant Attorney General James F. Rill*, 63 Antitrust & Trade Reg. Rep. (BNA) 254 (Aug. 27, 1992) (favoring "a per se illegality principle applied to resale price maintenance").

> must be balanced against its procompetitive consequences. Cases that do not fit the generalization may arise, but a per se rule reflects the judgment that such cases are not sufficiently *common or important* to justify the time and expense necessary to identify them.

433 U.S. at 50 n.16 (emphasis added).

"It is thus not enough to suggest that a class of restraints is sometimes or even often beneficial or harmful. The critical questions are always ones of frequency and magnitude relative to the business and legal alternatives." 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1628b, at 292 (2d ed. 2004).[14] As documented below, there is strong evidence that RPM can have, and often has had, significant anticompetitive effects. Abandoning the per se rule will inevitably mean an increased incidence of anticompetitive RPM, as well increased uncertainty for business and greater litigation expenses, particularly if the Court adopts an unstructured rule of reason in place of the per se rule. At the same time, there is no evidence that the *Dr. Miles* rule harms consumer welfare. Petitioner has not shown that procompetitive uses of RPM are common or important nor that less restrictive alternatives are more costly or less effective. In short, even if the Court were approaching the issue *de novo*, there is ample reason for having a per se rule against minimum RPM, as most countries do.[15]

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[14] *See also* Arndt Christiansen & Wolfgang Kerber, *Competition Policy With Optimally Differentiated Rules Instead of "Per Se Rules vs Rule of Reason"*, 2 J. Comp. L. & Econ. 215, 238 (2006) (explaining "error cost approach" in law and economics, and observing that to justify abandoning prohibition of RPM, "it is not sufficient to show that that there are cases in which resale price maintenance can lead to positive welfare effects").

[15] Many scholars concur. *See, e.g.*, Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L. J. 1487, 1495 (1983) (Pitofsky); Robert Pitofsky, *Are Retailers Who Offer Discounts Really "Knaves"?: The Coming Challenge to the* Dr. Miles *Rule*, Antitrust, Spring 2007 (forthcoming); Jean Wegman Burns, *Vertical Restraints, Efficiency and the Real World*, 62

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A. The Anticompetitive Effects Of RPM Are Significant

1. **Higher prices.** The function of RPM is to raise resale prices to consumers and there is no dispute that RPM generally has that effect. *See* 8 Areeda & Hovenkamp ¶1604b, at 40 (RPM "tends to produce higher consumer prices than would otherwise be the case. The evidence is persuasive on this point."). This is enough to make it competitively suspect, *see National Soc'y of Professional Engineers v. United States*, 435 U.S. 679, 692 (1978) ("[p]rice is the 'central nervous system of the economy'") (quoting *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 226 n.59 (1940)), and was the main reason Congress repealed the fair trade laws.[16] Studies of the fair trade era

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Ford. L. Rev. 597 (1993) (advocating retention of *Dr. Miles* rule); David F. Shores, *Vertical Price-Fixing and the Contract Conundrum: Beyond* Monsanto, 54 Ford. L. Rev. 377 (1985) (same); *see also* Edward Iacobucci, *The Case for Prohibiting Resale Price Maintenance*, 19 World Comp. L. & Econ. Rev., Dec. 1995, at 71, 101 (Iacobucci) (advocating per se rule because "the number of cases where RPM is efficient will probably be rather small," "suitable alternatives exist that do not involve price setting," and "the cost of a rule-of-reason review is likely to be significant"). This is in contrast to the scholarly commentary on *Albrecht* and *Schwinn*, the overwhelming consensus of which was critical.

[16] The 1975 Act itself is titled, "An act to Amend the Sherman Antitrust Act to provide lower prices for consumers." The significance of low prices to the Court's vertical restraints jurisprudence was confirmed by *Khan*, where the Court reiterated that "[l]ow prices . . . benefit consumers regardless of how those prices are set," and "condemnation of practices resulting in lower prices to consumers is especially costly because cutting prices to increase business often is the very essence of competition." 522 U.S. at 15 (internal quotes omitted). Thus, the Court found that the per se rule against maximum RPM could not be sustained because maximum RPM was used to keep consumer prices low, notwithstanding that in some cases the prices might be set too low for dealers to offer consumers essential or desired services. As one member of the Court noted at the *Khan* oral argument, the distinction between maximum RPM and minimum RPM is that "the one, means the consumer pays low prices; in the other, high prices. Where the consumer pays high prices, that's likely to be bad. Where the consumer pays lower prices, that's likely to be good." Trans. of Oral Argument, *State Oil Co. v. Kahn*, 1997 U.S. Trans. LEXIS 81 (Oct. 7,

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show that prices of items subjected to fair trade were significantly higher in states where fair trade was permitted than in states where RPM was illegal, and that fair trade cost consumers several *billion* dollars a year. *See* House Rep. 3; *see also* F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy"*, 1 Comp. Policy Int'l, Autumn 2005, 65, 72-74 (reviewing studies showing substantial consumer savings from termination of RPM in light bulb, retail drug, blue jeans, and other sectors). More recently, music companies' efforts to restrain resale prices of CDs was estimated by the FTC to have cost consumers as much as $480 million. *See* F.T.C., *Record Companies Settle FTC Charges of Restraining Competition in CD Music Market*, May 10, 2000.[17]

2. **Reduced innovation and efficiency in retailing.** In addition to raising prices, RPM has a tendency to retard innovation and efficiency in retailing. *See* Robert L. Steiner, *How Manufacturers Deal With the Price-Cutting Retailer: When are Vertical Restraints Efficient?*, 65 Antitrust L.J. 407, 424 & n.47 (1997) (Steiner) ("growth of . . . more efficient new retailing forms often has been seriously

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1997). To be sure, this Court in *Business Elecs.* noted that "all vertical restraints . . . have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that," 485 U.S. at 728, but in fact nonprice restraints often are *not* intended to increase price and always permit the retailer to engage in price competition with competing brands. *See infra.*

[17] Petitioner and its *amici* argue that preserving "dealer freedom" cannot justify the *Dr. Miles* rule. Plainly, the principal concern of Congress in repealing the fair trade laws was to protect consumers, and *Khan* recognized that dealer freedom to set high prices could not trump consumers' interests in low prices. But dealer freedom to compete with lower prices is another matter, and was recognized by Congress as an interest deserving protection. *See* House Rep. 3 ("Some retailers prefer to try to enlarge their share of the market by competing vigorously in price – precisely the sort of behavior encouraged by our antitrust laws."); *see also* Thomas B. Leary, *Freedom as the Core Value of Antitrust in the New Millennium*, 68 Antitrust L. J. 545, 552 (2000) ("dealer freedom is a protected value, but only along with the freedom of other actors").

retarded by their inability to obtain well-known manufacturers' brands, free of RPM"); 8 Areeda & Hovenkamp ¶1632c4, at 320 ("When resale prices are not fixed, price competition among dealers favors the expansion of those with efficient scale and methods, thus lowering the cost of distribution."); Lawrence A. Sullivan & Warren S. Grimes, *The Law of Antitrust: An Integrated Handbook* §6.3a2, at 335 (2d ed. 2006) ("Preserving entry opportunities for new retailers and new retailing approaches is a critical component to the dynamic growth of our economy. Intrabrand competition serves this goal by preserving one of the new entrant's most competitive tools: the ability to discount popular branded items that draw customers."). *See also* Brief of *Amicus Curiae* Consumer Federation of America 5-11.

3. **Protection of retailer interests.** Petitioner and its *amici* suggest that the obvious anticompetitive effects of RPM should be ignored because a manufacturer ordinarily benefits from low resale prices; hence if the manufacturer adopts RPM, it must believe it is necessary to achieve distribution efficiencies. That is not the case. If a manufacturer adopts RPM at the behest of its retailers, then this presumption evaporates. *See* Brief for William S. Comanor & Frederic M. Scherer as *Amici Curiae* 8 ("[T]here are no arguments in economic analysis supporting restraints arising from distributor actions or pressures. In such circumstances, RPM and similar restraints lead to higher consumer prices with no demonstrated redeeming values. . . . "); *Toys "R" Us, Inc. v. F.T.C.*, 221 F.3d 928, 938 (7th Cir. 2000) ("the rationale for permitting restricted distribution policies depends on the alignment of interests between consumers and manufacturers. Destroy that alignment and you destroy the power of the argument.") (internal quotes omitted). The United States insists that "RPM generally emanates from the *manufacturer*," U.S. Br. 18, but that assertion is belied by the historical record. As Professors Areeda and Hovenkamp conclude, "the Court's perception [in *Dr. Miles*] that dealer power may be the predominant explanation for much resale price maintenance may have been accurate."

8 Areeda & Hovenkamp ¶1620c4, at 217; *see also id.* ¶1604a, at 35 ("[M]anufacturers have often restrained intrabrand competition – especially through resale price maintenance – not to achieve more effective distribution but rather to appease dealer interests in excess profits or the quiet life.").

The retailer power explanation for RPM does not rely on the existence of a retailer cartel, or even tacit retailer collusion.[18] Rather, "[a] manufacturer might be forced to restrain distribution in order to appease one or more individually powerful dealers," 8 Areeda & Hovenkamp ¶1604d2, at 47, or may adopt RPM based on the calculation that it has more to lose from its incumbent high-cost retailers than to gain from emerging lower cost retailers.[19]

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[18] Thus the contention by petitioner and its *amici* that the empirical evidence (essentially three reviews of litigated cases) does not suggest that minimum RPM often facilitates dealer cartels is beside the point. Further, the contention simply ignores that "[a] wealth of history shows that dealers have attempted to use RPM imposed by suppliers to facilitate horizontal dealer collusion." Herbert Hovenkamp, *Federal Antitrust Policy* 451 (3rd ed. 2005); *see* Thomas R. Overstreet Jr., *Resale Price Maintenance* 15 n.1 (FTC 1983) (explaining that "the literature contains numerous examples where analysts have attributed the existence of RPM to pressures from organized trade groups, rather than to manufacturers' attempts to deal with 'free-rider' problems," citing Palamountain, Bowman, Yamey, and Hollander). Professor Hovenkamp criticizes the conclusions about collusion drawn from studies of litigated RPM cases because, in addition to the fact that the studies do not consider tacit collusion, "litigated cases probably represent a skewed sample" (i.e., are more marginal than the overall pool of cases) and plaintiffs had no need to allege collusion "since RPM is independently illegal." Hovenkamp, *supra*, 464 & n.19; *see also* Iacobucci 96 (similar criticism).

[19] *See* Steiner 426; *see also* 8 Areeda & Hovenkamp ¶1604d3, at 48, 49 ("Multibrand dealers' ability to substitute other brands gives the dealers considerable leverage."); William S. Comanor, *The Two Economics of Vertical Restraints*, 21 Sw. U. L. Rev. 1265, 1276-81 (1992) (monopsony power arises from pervasive economies of scope in distribution sector); *cf. Toys "R" Us*, 221 F.3d at 930 (large toy manufacturers acceded to demands of Toys "R" Us to restrict distribution to lower margin warehouse clubs because manufacturers felt they could not find other retailers to replace it).

The increasing concentration of retail markets in recent years and rise of buyer power suggests that the risks of retailer-induced RPM have only increased since fair trade was repealed.[20]

4. **Restricted interbrand competition.** The assumption that manufacturers have the same interest as consumers in low reseller prices is also belied by manufacturers' incentive to adopt RPM in order to protect their own wholesale margins. Retail discounting is often harmful to the manufacturer because it puts pressure on the manufacturer to reduce its wholesale prices. *See* 8 Areeda & Hovenkamp ¶1606c, at 85-86.[21] Even without dealer pressure, it is widely recognized that RPM may be used to restrict interbrand competition by facilitating coordinated pricing by manufacturers. Petitioner and its *amici* acknowledge that RPM might be used to facilitate a cartel at the manufacturer level, *see* Brief of *Amici Curiae* Economists 13 (Econ. Br.) (objection "had some traction historically"), but claim that this is not likely to be common and

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[20] To be sure, the Court in *Business Elecs.* stated that "[r]etail market power is rare, because of the usual presence of interbrand competition and other dealers," 485 U.S. at 727 n.2, but this is difficult to square with current realities. *See, e.g.*, Deloitte, *2007 Global Powers of Retailing*, Stores, Jan. 2007, at 2-G8 (combined sales of ten largest retailers worldwide has grown to nearly 30% of total retail sales of top 250 retailers); OECD, *Buying Power of Multiproduct Retailers* 7 (1999) ("last twenty years have seen momentous changes in retail distribution including significant increases in concentration").

[21] *See also* Steiner 441-42 (RPM may be used to tame the exercise of countervailing retail power); David Gilo, *Retail Competition Percolating Through to Suppliers and the Use of Vertical Integration, Tying, and Vertical Restraints To Stop It*, 20 Yale J. Reg. 25 (2003) (explaining how RPM offsets manufacturer's incentive to offer selective price cuts to distributors); *e.g.*, *In re Time Warner, Inc.*, 2000 FTC LEXIS 40 (2000) (music companies' restriction on resale prices designed to shore up wholesale prices); *accord* S. Robson Walton, *Antitrust, RPM, and the Big Brands: Discounting in Small-Town America (II)*, 15 Antitrust L. & Econ. Rev. No. 2, at 11, 16 (1983) (Wal-Mart senior executive stating "I don't have any question but that competitive pricing at the retail level creates more pressure on manufacturers' factory prices than is present when they're able to set retail prices").

in any event may be controlled by the per se rule against horizontal price fixing. However, RPM can be used as a facilitating device not only to enforce an unlawful cartel, but to dampen price competition among oligopolistic manufacturers. *See* 8 Areeda & Hovenkamp ¶1606d-f, at 86-92 (RPM reinforces manufacturer coordination, whether express or tacit, by reducing utility of wholesale price cuts and increasing visibility of prices; "danger is more than theoretical").[22]

Petitioner and its *amici* contend that the existence of interbrand competition will prevent the exercise of intrabrand market power by retailers, quoting *Sylvania* to that effect. *See* 433 U.S. at 52 n.19. Of course, *Sylvania* nonetheless upheld the per se rule for RPM. In any event, the existence of interbrand competition obviously does not check intrabrand market power when RPM is itself used to restrict interbrand competition. Moreover, it is commonly understood by economists that neither retailers nor manufacturers will engage in RPM without some interbrand market power.[23]

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[22] Again, the reliance by petitioner and its *amici* on three empirical studies of litigated cases that conclude that RPM has not been frequently used to support a manufacturer's *cartel* is beside the point. None of the studies addresses whether RPM may have been used to facilitate oligopoly pricing. And even as to cartel facilitation, the studies are flawed. *See supra* note 18; *see also* 8 Areeda & Hovenkamp ¶1606f, at 91 (criticizing Ornstein study). Moreover, petitioner and its *amici* ignore other evidence that RPM has often been used in conjunction with manufacturer cartels. *See* Overstreet, *supra*, at 22 ("The economics literature contains several examples of possible collusion among manufacturers which may have been facilitated by RPM."). For a recent example, *see* Dept. of Justice, *Massachusetts Tampico Fiber Distributor Charged in Price Fixing Conspiracy*, Aug. 29, 1996 ("textbook example of a cartel among producers enhanced and strengthened by a resale price agreement").

[23] *See* Ward Bowman, Jr., *The Prerequisites and Effects of Resale Price Maintenance*, 22 U. Chi. L. Rev. 825, 849 (1955) ("Price maintenance appears to be incompatible with an assumption of pure competition among both sellers and resellers."); 8 Areeda & Hovenkamp ¶1632e2, at 324-25 ("most products subject to RPM are sufficiently differentiated to enjoy greater pricing discretion than is possible for perfectly competitive products"); *see also* Sullivan & Grimes §7.2b, at

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B. The Procompetitive Uses Of RPM Are Not Common Or Important

Against the history of the use of RPM for anticompetitive purposes, petitioner and its *amici* offer theories under which RPM *could* be procompetitive. Particularly in the context of overturning a keystone antitrust precedent, the Court should insist on evidence that petitioner's theories are common explanations for real world events. However, the few empirical studies cited provide minimal support for procompetitive explanations, as the States' amicus brief demonstrates, and no evidence that less restrictive alternatives would not serve equally as well in the limited instances where procompetitive explanations are likely.

1. **Free-rider argument.** Petitioner and its *amici* focus primarily on the "free rider" theory, contending that RPM can benefit consumers because the higher prices may induce retailers to provide pre-sale services that promote interbrand competition. This "modern" economic theory (dating back to Telser in 1960) was well known to Congress in 1975 and the Court in *Sylvania*, but nonetheless was rejected as a basis for permitting RPM.[24] As Professors Comanor and Scherer point out, "there is skepticism in the economic literature about how often [free riding] occurs."[25] Moreover, as *amici* economists

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379 (the more effective a vertical restraint is in differentiating a brand, the greater the *reduction* in interbrand competition).

[24] *See supra* note 7. The suggestion by the United States and CTIA that the free-rider problem has been exacerbated by the growth of Internet commerce, *see, e.g.*, U.S. Br. 13, illustrates the weakness of the free rider argument, as the growth of Internet commerce has only increased the efficiency of retail markets and increased sales of "bricks and mortar" retailers. *See, e.g.*, Kortney Stringer, *Style & Substance: Shoppers Who Blend Store, Catalog and Web Spend More*, Wall St. J., Sept. 3, 2004, at A7 ("After initial worries that the Internet would steal sales from stores, retailers now are realizing that just the opposite is happening.").

[25] Comanor & Scherer Br. 6; *see also* F. M. Scherer & David Ross, *Industrial Market Structure and Economic Performance* 552 (3rd ed. 1990) ("relatively few products qualify ... under Telser's free-rider theory"); 8 Areeda & Hovenkamp ¶1601e, at 13 ("[U]nrestrained intrabrand competition does not lead to substantially detrimental free

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Klein and Murphy have noted elsewhere, the standard free-rider theory for RPM is "fundamentally flawed" because it is based on "the unrealistic assumption that sole avenue of nonprice competition available to retailers is the supply of the particular services desired by the manufacturer."[26] The "quality certification" version of the free-rider theory, which has limited applicability on its own terms, is similarly flawed.[27] Furthermore, even if RPM is used to prevent free riding and increase output, while it may be profit-maximizing for the manufacturer, there is no *a priori* reason to believe that consumers as a whole benefit because most consumers may prefer the lower-priced product without the services. Comanor & Scherer Br. 4-5; *see also* Econ. Br. 10 (noting that Scherer & Ross have shown "that RPM may reduce both consumer and social welfare under a plausible hypothesis regarding the impact on demand for the product").

2. **Other "procompetitive" theories.** Petitioner and its *amici* maintain that RPM can enhance interbrand competition even without free riding because "RPM provides retailers with an incentive to make non-price sales efforts that attract customers away from other

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riding when dealers provide no significant services (such as drugstores selling toothpaste), the services they do provide cannot be utilized by customers who patronize other dealers (luxurious ambience), the services are paid for separately (post-sale repair), the services provided are not brand specific and are fully supported by a wide range of products (high-quality department store), the services can be provided efficiently by the manufacturer (advertising), or a sufficient number of consumers patronize the dealers from whom they receive the service."); *id.* ¶1611f, at 134 ("for most products, low-service discounting dealers do not impair the viability of full-service dealers; both exist side by side").

[26] Benjamin Klein & Kevin Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J. Law & Econ. 265, 266 (1988) ("No matter how large a margin is created by resale price maintenance, there appears to be no incentive for competitive free-riding retailers to supply the desired . . . services.").

[27] *See* Iacobucci 80-82; *see also* 8 Areeda & Hovenkamp ¶1613g, 156-65 (quality certification theory is "relatively weak" largely because elite dealers' services are usually not brand specific and RPM in this context may well reflect dealer power).

brands." U.S. Br. 15. The logic of the non-free-rider theories is not obvious because, absent free riding, the retailer has every incentive to offer services that consumers prefer.[28] Furthermore, insofar as higher retailer margins induce multibrand retailers to undertake nonprice sales efforts to favor one brand over another, the result is generally *anticompetitive*, not procompetitive. *See* 8 Areeda & Hovenkamp ¶1614, at 165-71 (rejecting dealer "goodwill" as justification for RPM; providing multibrand retailers with higher margin to push particular brand leads to deception of consumers and reflects retailer power); Sullivan & Grimes §6.3c2, at 343.

3. **Less restrictive alternatives.** Any procompetitive effects of RPM can be achieved by less restrictive means that do not prevent efficient retailers from passing on the benefits of their efficiency to consumers. *Amici* economists recognize that manufacturers may curtail free riding by other means, and that where such means are available, "RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition." Econ. Br. 9. The United States apparently agrees.[29] The most obvious way to ensure desired retailer services is to pay retailers for performing those services. *See Toys "R" Us*, 221 F.3d at 933, 938

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[28] Also, Klein and Murphy's "contractual fidelity" theory, Winter's "inter-retailer v. product margin" theory, and Deneckere et al.'s "demand uncertainty" theory suffer from the limitation that the theories have neither been shown to be of significance in the real world nor that the concerns they address could not be resolved equally as well by techniques other than RPM. *See* Iacobucci 84-89; *see also* Ittai Paldor, *Rethinking RPM: Did the Courts Have it Right All Along?* 52-72, 206-15 (Working Paper 2007) (Paldor), at http://papers.ssrn.com.

[29] *See* U.S. Br. 23 ("the per se prohibition against RPM does not prevent manufacturers from engaging in other conduct that achieves similar results"); *see also* U.S. *Khan* Br. *18 n.8 ("in the case of vertical minimum price fixing, suppliers' stated concerns (such as inducing dealers to provide adequate point-of-sale services) could often be addressed directly in a distribution agreement without reference to price (by, for example, requiring the distributor to provide a certain level of facilities or services to its customers)").

(rejecting free-rider argument because services performed by retailer, such as advertising, warehousing and full-line stocking, were compensated by manufacturer). Petitioner has failed to demonstrate that these alternatives have proven to be inadequate or costly.[30]

C. Having Different Rules For Price And Nonprice Restraints Makes Sense

"It is . . . entirely reasonable to regard resale price maintenance as a more pervasive threat to competition than nonprice restraints." 8 Areeda & Hovenkamp ¶1630b, at 303. "Nonprice restraints fulfill a wider range of potentially legitimate objectives and threaten fewer harms to competitive interests" than RPM. *Id.* 302. The Court in *Sylvania* distinguished price and nonprice vertical restraints on the ground that RPM "almost invariably" reduces interbrand competition. 433 U.S. at 51 n.18 (quoting Justice Brennan's concurring opinion in *White Motor*). Indeed, RPM *is* more likely than nonprice restraints to restrict interbrand competition at both the

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[30] *See* Steiner 427-29. The Robinson Patman Act is no impediment to reimbursing retailers for services that benefit the supplier. *See* Richard M. Steuer, *Dysfunctional Discounts*, Antitrust, Spring 2005, at 75, 79. *Amici* economists maintain that paying dealers for services may not be as efficient as RPM "*under some circumstances*" because "it may be difficult to specify completely all of the services that the retailer must perform and the level that the retailer must perform them," or because it is "possible that the retailer, rather than the manufacturer, knows which retail-level services will be the most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer." Econ. Br. 9 (emphasis added). However, no evidence is offered as to empirical relevance of these possibilities. Moreover, merely raising retailer margins through RPM – without contractual service requirements – is generally ineffective in curtailing free riding. *See supra* note 26. It is not apparent why a retailer would choose to provide services that the manufacturer does not even ask for when other retailers are not also required to provide such services, unless the services themselves are profitable for a retailer, which means that RPM is not necessary in the first place.

retailer and manufacturer levels. At the retailer level, only RPM restricts dealers from competing on price against other brands.[31] And RPM, unlike nonprice restraints, prevents more efficient retailers from passing on the benefits of that efficiency to consumers.[32] Furthermore, RPM stultifies competition among multibrand retailers, which are generally not susceptible to territorial or customer restraints. *See* 8 Areeda & Hovenkamp ¶1604g6, at 65. As a general matter, "[t]he form of restraint most likely to reflect dealer power is resale price maintenance." *Id.*; *see also id.* ¶1630b, at 303 ("Historically . . . price rather than nonprice restraints have been the vehicle chosen by dealer organizations to limit competition among their members.").

The Court in *Sylvania* also distinguished price and nonprice vertical restraints on the ground that price restraints can facilitate a cartel. 433 U.S. at 51 n.18; *see also Business Elecs.*, 485 U.S. at 725-26 (noting that authorities cited by *Sylvania* suggested RPM may assist cartelization, but "[s]imilar support for the cartel-facilitating effect of vertical nonprice restraints was and remains lacking"); 8 Areeda & Hovenkamp ¶1606, at 99 ("[M]ost nonprice restraints lack the characteristics that enable [RPM] to support price coordination among manufacturers."). Petitioner and its *amici* do not challenge this distinction, but rather argue that cartelization is still not a common use for RPM. However, as pointed out above, the evidence on this score is contested, and petitioner and its

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[31] Even airtight territorial exclusives allow restricted dealers to fully compete in their territories against dealers of other brands, but RPM prevents dealers "from engaging resellers of other brands in price competition." 8 Areeda & Hovenkamp ¶1630b, at 303.

[32] *See* Arthur H. Travers, Jr. & Thomas D. Wright, *Restricted Channels of Distribution Under the Sherman Act*, 75 Harv. L. Rev. 795, 801 (1962) (noting territorial and customer restraints do not have "settled propensity of resale price maintenance to prevent dealers or distributors from passing the benefits of efficient distribution on to consumers by adopting a high-volume, low-markup policy") (cited by Justice Brennan in *White Motor Co. v. U.S.*, 372 U.S. 253, 268 n.7 (1963)).

amici ignore the fact that RPM may facilitate coordinated pricing as well as an actual cartel. *See supra.*

Besides doing less harm, nonprice vertical restraints are more likely to have procompetitive benefits than RPM. Nonprice vertical restraints have a wider range of legitimate justifications, including ensuring efficient dealer scale, focusing dealer effort on developing classes of customers or territories, and promoting product quality and safety. *See* 8 Areeda & Hovenkamp ¶1647; *Sylvania*, 433 U.S. at 55 n.23. Moreover, to the extent that territorial or customer restraints entirely eliminate intrabrand competition, they are more likely than RPM to solve free-rider problems because a service-providing dealer under RPM may lose business to free-riding dealers that maintain the same prices but offer other inducements to customers. *See* Sullivan & Grimes §6.3b, at 338; Paldor 293.

D. Foreign Jurisdictions, Including The EU And Canada, Generally Ban Minimum RPM

Antitrust authorities around the world generally ban minimum RPM and treat it more harshly than nonprice vertical restraints.[33] For example, the European Union, which recently liberalized its treatment of most nonprice restraints, continues to treat minimum RPM as a "hard-core" restraint, equivalent to per se illegal.[34] Member States, many of which led the U.S. in abolishing fair trade,

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[33] *See* OECD, *Resale Price Maintenance* 10 (1998) (OECD *RPM*) (reporting that "RPM is generally prohibited in almost all OECD countries, subject to a few exemptions, mostly for books, newspapers and medicaments."), at http://www.oecd.org/dataoecd/35/7/1920261.pdf.

[34] Commission Regulation (EC) 2790/1999, 1999 O.J. (L336) 21. Most vertical nonprice restraints, as well as maximum RPM, are presumptively lawful if undertaken by a supplier with a market share of less than 30%. *See id.*; Joseph F. Winterscheid & Margaret A. Ward, *Two Part Harmony: New Rules for Vertical Agreements Under European Union Competition Policy*, Antitrust, Summer, 2000, at 52.

follow suit.[35] Canada treats RPM as a criminal offense.[36] The rest of the advanced industrialized world, like Congress, recognizes the wisdom of the *Dr. Miles* rule.[37]

E. Difficulty Distinguishing "Unilateral" Conduct Under *Colgate* and Unlawful RPM Does Not Justify Abandoning the Per Se Rule

Petitioner and several *amici* suggest that confusion in the *Colgate* doctrine, which permits manufacturers "unilaterally" to impose RPM, militates in favor of repealing *Dr. Miles*. There are several responses. As an initial matter, the tension between *Dr. Miles* and *Colgate* has existed since *Colgate* was decided in 1918. The fact that manufacturers may coerce compliance with suggested resale prices by threatening to refuse to deal with discounters has never been thought to justify abandoning *Dr. Miles*, but rather has been accepted as essentially an exception justified by the need to protect a certain degree of manufacturer freedom.[38] Second, any confusion arising from the *Colgate* doctrine will persist regardless of whether RPM is treated as per se illegal or analyzed under the rule of reason (unless of course RPM is made *de facto* legal, *see infra*). Indeed, to the extent business certainty

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[35] *See, e.g.*, II ABA Section of Antitrust Law, *Competition Laws Outside the United States* France-42, Germany-33, United Kingdom-56 (2001); *see also* Paldor 53-54; Scherer & Ross, *supra*, at 549-50.

[36] *See Record Canadian Fine is Levied in Resale Price Maintenance Case*, 83 Antitrust & Trade Reg. Rep. (BNA) 410 (Oct. 25, 2002).

[37] *See* OECD *RPM* 130 (EC official explaining anticompetitive effects of RPM and that "if one supposes that RPM can improve efficiency, this economic efficiency could be achieved by less costly means in terms of competition").

[38] *See U.S. v. Parke, Davis & Co.*, 362 U.S. 29, 44 (1960). It has also been suggested that insofar as the determination of "unilateral" conduct under *Colgate/Monsanto* focuses on whether the conduct is in the independent best interest of the manufacturer, then the doctrine screens out instances of RPM that are less likely to be anticompetitive. *See* Hovenkamp, *supra*, at 471.

about the rules of the game is problematic now, it would only be worsened by abandoning *Dr. Miles* in favor of an unstructured rule of reason. *See* 8 Areeda & Hovenkamp ¶1633b, at 330 (an "open [ended] approach to resale price maintenance would obviously create great uncertainty."). Third, if there is confusion in the application of the *Colgate* doctrine, then the logical solution is to attack the problem directly rather than indirectly by modifying *Dr. Miles*. The academic critique of the *Colgate* doctrine has been far more severe and universal than the criticism of *Dr. Miles*. *See* Sullivan & Grimes §7.2c, at 382 n.50. Fourth, the claim of business uncertainty is overstated and arises in many contexts requiring antitrust counsel. *See* 8 Areeda & Hovenkamp ¶1630d, at 305-06.

III. OVERRULING *DR. MILES* IN FAVOR OF THE *SYLVANIA* RULE OF REASON WOULD BE COSTLY

Petitioner and the United States urge that RPM be analyzed under the same rule of reason applicable to nonprice restraints under *Sylvania*.[39] Pet. Br. 36-39; U.S. Br. 28. Adopting the *Sylvania* rule of reason would inevitably increase the incidence of anticompetitive RPM, as few cases would be brought either by private parties or the government under the Sherman Act.[40] As Professor (and former FTC chair) Pitofsky notes, "rule of reason cases often take years to litigate and are extremely expensive" and "it is very difficult for a plaintiff (either

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[39] In *Sylvania* the Court did not specify how the rule of reason should be implemented, but rather merely stated that the "factfinder weighs all of the circumstances of a case," and referred to the open-ended test of *Chicago Board of Trade*. *See* 433 U.S. at 49 & n.15.

[40] A rule of reason would also increase the incidence of anticompetitive RPM because it denies the manufacturer an important tool in combating retailer pressure to adopt RPM. *See* 8 Areeda & Hovenkamp ¶1632b, at 319 ("There is little doubt that per se illegality strengthens the hands of manufacturers in resisting dealer demands for price protection.").

the government or a private party) to win a rule of reason case." Pitofsky 1489. Indeed, most commentators agree that the *Sylvania* rule of reason, as applied by the lower courts, has resulted in a rule of *de facto* per se legality for nonprice vertical restraints.[41] To be sure, the government occasionally brings a successful nonprice vertical restraint case, but such cases have often involved per se elements.[42]

Another cost of abandoning *Dr. Miles* is the uncertainty for businesses that would likely result from the fact that many states ban RPM, sometimes expressly. *See, e.g.*,

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[41] *See, e.g.*, Douglas H. Ginsburg, *Vertical Restraints: De Facto Legality Under the Rule of Reason*, 60 Antitrust L.J. 67 (1991). Plaintiffs cannot win nonprice restraints cases not because such restraints are never anticompetitive, but rather because the hurdles for recovery are so high. Not only must plaintiffs jump through the "agreement" hoops that the Court has established for RPM, *see, e.g., Parkway Gallery Furn., Inc. v. Kittinger/Pennsylvania House Group, Inc.*, 878 F.2d 801 (4th Cir. 1989), but, as petitioner points out, lower courts have ordinarily required plaintiffs to make a threshold showing that the manufacturer has market power, Pet. Br. 37, and "[m]ost cases have made clear that power will not be inferred unless the defendant's market share is significant." 8 Areeda & Hovenkamp ¶1645c, at 404-05. Whatever the merits of a market share screen for nonprice restraints, *see* Sullivan & Grimes §7.3a1, at 384-88 (noting that firms with small market shares but powerful brands may have significant market power), it is not responsive to the risks of RPM such as dealer pressure and facilitating coordinated interaction among manufacturers or dealers. *See* 8 Areeda & Hovenkamp ¶1633c, at 330-32.

[42] Thus in *Toys "R" Us*, for example, the government prevailed by proving a horizontal group boycott by manufacturers orchestrated by the retailer. 221 F.3d 928. And in the minimum advertised pricing case brought against the music companies, the FTC found that their cooperative advertising programs, although not per se illegal, had effectively eliminated the ability of retailers to sell at a discount (because all discount advertising was forbidden) and stated that "henceforth . . . arrangements that have the same practical effect" as minimum RPM would be considered "unlawful . . . without a detailed market analysis, even if adopted by a manufacturer without substantial market power." *Time Warner*, 2000 FTC LEXIS 40, *32. Reversing *Dr. Miles* would presumably preclude such a rule and likely hamper the ability of the FTC to obtain settlements in cases like *Time Warner*.

N.Y. Gen. Bus. L. §369-a (2007). Repealing *Dr. Miles* threatens to recreate the balkanized state of affairs that existed prior to the Consumer Goods Pricing Act of 1975, when fair trade was legal in some states and illegal in others. Indeed, given the anti-consumer effect of RPM, states that follow the Sherman Act can be expected to adopt "Leegin repealers" (either by statute or judicial construction), perhaps replicating the confusion, uncertainty, and expense that has resulted from the divergent treatment of indirect purchaser damage actions under the Sherman Act and state law. *See* Donald I. Baker, *Hitting the Potholes on the* Illinois Brick *Road*, Antitrust, Fall 2002, at 14.

IV. IF THE COURT OVERRULES *DR. MILES*, IT SHOULD ADOPT A REBUTTABLE PRESUMPTION THAT MINIMUM RPM IS UNLAWFUL

The case for overruling *Dr. Miles* has not been made. However, if the Court determines otherwise, it should adopt a rebuttable presumption that RPM is unlawful, rather than an open-ended rule of reason.[43] Such an

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[43] Many commentators who do not favor a per se rule advocate treating RPM as presumptively unlawful or otherwise reject a *Sylvania* rule of reason. *See, e.g.*, 8 Phillip E. Areeda, *Antitrust Law* ¶1633c, at 378-81 (1989) (would allow RPM if defendant proves the absence of number of specified factors); Thomas R. Overstreet Jr. & Alan A. Fisher, *Resale Price Maintenance and Distribution Efficiency: Some Lessons from the Past*, 3 Contemp. Policy Issues 43, 53-54 (1985) (maintaining that rule of reason would be "a litigation nightmare" and advocating compromise of continuing per se ban with limited exceptions, such as for new entrants and firms with small market shares if the largest firms do not use RPM); Comanor & Scherer Br. 8-9 (maintaining that Court should treat distributor-induced RPM as per se illegal and evaluate other instances under structured rule of reason); Jayma M. Meyer, *Relaxation of the Per Se Mantra in the Vertical Price Fixing Arena*, 68 S. Cal. L. Rev. 73 (1994) (advocating rebuttable presumption of illegality); Thomas A. Piraino, Jr., *Reconciling the Per Se and Rule of Reason Approaches to Antitrust Analysis*, 64 S. Cal. L. Rev. 685 (1991) (advocating ancillary restraints approach under which RPM induced by dealer coercion would be summarily condemned).

approach does less violence to the 96 years of this Court's jurisprudence firmly holding that RPM is illegal, and is more respectful of the determination by Congress and the States over the last 32 years that RPM is pernicious. A presumption of illegality is also warranted by the simple fact that RPM ordinarily *directly* raises prices to consumers and by the absence of theoretical and empirical evidence that consumers *generally* benefit from these higher prices. *Cf. NCAA v. Board of Regents*, 468 U.S. 85, 110 (1984) ("naked restraint on price and output requires some competitive justification even in the absence of a detailed market analysis"); *Polygram Holding, Inc. v. F.T.C.*, 416 F.3d 29, 36 (D.C. Cir. 2005) (restraint is presumed unlawful if "it is obvious that a restraint of trade likely impairs competition"). If businesses wish to raise prices to consumers by agreement, it is hardly unreasonable to place the burden on them to justify the practice in a particular case.

Under this approach, a manufacturer may rebut the presumption of illegality by proving that RPM is reasonably necessary to achieve a legitimate business purpose that benefits consumers. *Cf. Polygram*, 416 F.3d at 36 (to rebut presumption "defendant must either identify some reason the restraint is unlikely to harm consumers or identify some competitive benefit that plausibly offsets the apparent or anticipated harm."). "To prove a legitimate purpose, the manufacturer must offer proof that it has such a purpose and that the restraint serves it." 8 Areeda ¶1633d2, at 384. In addition, there must be substantial evidence that less restrictive alternatives (e.g., promotional allowances) "would be significantly more costly or significantly less effective." *Id.* at 386; *see Dr. Miles*, 220 U.S. at 406 (to sustain restraint it must be "limited to what is fairly necessary, in the circumstances of the particular case"). Evidence that RPM was imposed in response to pressure from a significant retailer or retailers would militate against any legitimate purpose. *See* 8 Areeda & Hovenkamp ¶1648, at 442; Comanor & Scherer Br. 9.

If the manufacturer rebuts the presumption of illegality by proving a legitimate business purpose that benefits consumers, the burden would shift to the plaintiff to establish that RPM is nonetheless anticompetitive. *Cf. Polygram*, 416 F.3d at 36 (defendant's justification may be rebutted with sufficient evidence "to show that anticompetitive effects are in fact likely"). For example, the plaintiff may show that RPM facilitates a manufacturer's cartel or oligopoly pricing, or significantly restricts consumer choice or retailing innovation. One way plaintiff could meet its burden is by showing that the upstream market is concentrated or by showing widespread coverage of RPM in downstream markets. *See* Comanor & Scherer Br. 9-10; 8 Areeda & Hovenkamp ¶1633c, at 330-31.[44]

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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February 26, 2007

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[44] If the Court overrules *Dr. Miles* because the goal is "to avoid the continued necessity to make tenuous distinctions between economically indistinguishable conduct," U.S. Br. 28, then the Court should also harmonize its definition of concerted action for horizontal and vertical restraints and treat RPM coerced by a manufacturer's threatened refusal to deal as an RPM agreement, subject to the presumption-based analysis. *See* Andrew I. Gavil et al., *Antitrust Law in Perspective* 363 (2002) (suggesting that "*Colgate's* fiction of 'no agreement' . . . might well be abandoned if *Dr. Miles* is ever overruled").

Supreme Court, U.S.
FILED
JAN 2 2 2007
OFFICE OF THE CLERK

(7)

No. 06-480

IN THE
Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.

Petitioner,

v.

PSKS, INC., D/B/A/ KAY'S CLOSET . . . KAY'S SHOES,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF THE AMERICAN PETROLEUM INSTITUTE AS AMICUS CURIAE SUPPORTING PETITIONER

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January 2007

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Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61 (1993) 11

INTEREST OF AMICUS CURIAE

The American Petroleum Institute ("API"), a non-profit District of Columbia corporation, is a national trade association for the U.S. oil and natural gas industry.[1] API's more than 400 members cover all facets of the industry, including exploration, production, transportation, refining, and marketing. Many of API's member companies are engaged in marketing petroleum products through dealers. API's members thus have a strong interest in the antitrust question before the Court in this case.

API frequently participates in legislative, administrative, and judicial proceedings that present issues of national concern, including issues involving interpretation of the antitrust laws. API participated as an *amicus curiae* in *State Oil v. Khan*, 522 U.S. 3 (1997), and has also participated in other cases before this Court presenting antitrust issues. *See, e.g., Bell Atlantic Corporation v. Twombly*, No. 05-1126 (argued Nov. 27, 2006); *Texaco, Inc. v. Dagher*, 126 S. Ct. 1276 (2006); *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 126 S. Ct. 860 (2006).

STATEMENT

Petitioner Leegin Creative Leather Products, Inc. produces women's fashion accessories. Since 1990,

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[1] Letters from Petitioner and Respondent consenting to the filing of amicus briefs are on file with the Clerk. Pursuant to Supreme Court Rule 37.6, counsel for API states that no counsel for a party authored this brief in whole or in part, and that no person or entity other than API, its members, or its counsel made a monetary contribution to the preparation or submission of this brief.

Petitioner has produced the "Brighton" brand line of women's belts and other accessories. Petitioner's marketing strategy for its Brighton line focuses on boutique stores offering a high level of service and personal attention. Pet. 2; 6 R. 5-11. In 1997, Petitioner adopted the "Brighton Pricing and Promotion Policy," which stated that Petitioner would do business only with retailers that followed Petitioner's suggested retail prices. Pet. 3; 6 R. 10. (The policy did not apply to Brighton products that a retailer chose not to reorder from Petitioner. Pet. 3 n.2.). Petitioner adopted the policy because it concluded that periodic sales would degrade the Brighton brand and cause customers to feel disaffected when they bought products that were not on sale. Pet. 3; 5 R. 106-24. Petitioner instead adopted an "everyday fair price" strategy. *Id.* In addition, Petitioner believed its policy would develop the Brighton brand by giving retailers an incentive to focus on Brighton products and provide a high level of service to customers. Pet. 3; 5 R. 115-27. Sales of Brighton products increased after the pricing policy went into effect. For example, sales of Brighton handbags grew from 125,609 units in 1996 to 375,480 units in 2003. Pet. 3.

Respondent PSKS sold Brighton products at its retail store, known as "Kay's Kloset," in Lewisville, Texas. Pet. 4. In late 2002, Petitioner learned that Respondent was selling Brighton products below the suggested retail prices. Pet. 4; 6 R. 112-13. In accordance with its policy, Petitioner suspended all shipments of Brighton products to Respondent. *Id.*

Respondent filed an action in federal district court contending that Petitioner's pricing policy amounted to an unlawful agreement in restraint of trade, in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. The district court barred Petitioner from introducing evidence that it lacks market power. In addition, the court excluded evidence that Petitioner's pricing policy promotes rather

than harms interbrand competition. The district court also denied Petitioner's request for a jury instruction that would have allowed the jury to apply the rule of reason. Instead, the court instructed the jury that the alleged resale price maintenance agreement was *per se* illegal. Pet. 4; 11 R. 42.

The jury found that Petitioner's policy constitutes a resale price maintenance agreement, and awarded Respondent $1.2 million in damages, which was trebled. The total judgment against Petitioner, including attorney's fees, was $3.975 million. Pet. App. 3a. In denying Petitioner's motion for judgment as a matter of law or for a new trial, the district court observed that "[w]hether the per se classification of such agreement is wise is not for this court to decide." *Id.* at 12a.

The court of appeals affirmed, noting that the lower courts "remain bound by [this Court's] holding in *Dr. Miles* [*Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911)]." Pet. App. 4a.

SUMMARY OF ARGUMENT

Section 1 of the Sherman Act, 15 U.S.C. § 1, prohibits only unreasonable restraints of trade. Ordinarily, a court determines whether a particular restraint of trade is unreasonable by applying the rule of reason, which requires the court to weigh the procompetitive benefits of a challenged practice against its anticompetitive harm. The Court has dispensed with case-by-case evaluation, and applied a *per se* rule of illegality, only when experience with a particular kind of restraint enables the Court to predict with confidence that the practice always, or almost always, harms competition.

In *State Oil v. Khan*, 522 U.S. 3 (1997), the Court overruled its decision in *Albrecht v. Herald Co.*, 390 U.S.

145 (1968), and held that vertical maximum resale price maintenance should be analyzed under the rule of reason rather than the *per se* rule. The Court relied on its decisions since *Albrecht*, which had substantially weakened its analytical underpinnings, as well as scholarly criticism of the decision.

The principles this Court recognized in *State Oil* support the conclusion that vertical minimum resale price maintenance, like vertical maximum resale price maintenance, should be analyzed under the rule of reason. There is widespread agreement among legal and economic scholars that vertical minimum resale price maintenance is not always, or almost always, anticompetitive. Minimum prices may enhance competition by ensuring that dealers provide the optimum level of service to consumers and preventing free-riding by dealers offering a lower level of service. Minimum prices may also encourage dealers to carry a larger quantity or selection of the manufacturer's products, or to provide shelf space for a new product.

There is no persuasive reason to draw a sharp line between vertical minimum resale price maintenance and other vertical restraints. As the Court has recognized, all vertical restraints have the potential to allow dealers to increase prices, and can be characterized as intended to do just that. Manufacturers have no incentive to provide services that consumers do not want, because doing so will likely decrease the manufacturers' overall sales and profits. Although vertical minimum resale price maintenance may harm competition in some circumstances, such as when it is used to facilitate horizontal price fixing among dealers or manufacturers, application of the rule of reason, together with the *per se* rule against horizontal price fixing, will protect consumers and competition without deterring procompetitive conduct. Accordingly, the Court should

reconsider its decision in *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), and apply the rule of reason rather than the *per se* rule to vertical minimum resale price maintenance.

The Court's decision in *Dr. Miles* should be reconsidered for the additional reason that its application often turns on unpredictable and economically irrelevant factors. This Court's decision in *United States v. Colgate & Co.*, 250 U.S. 300 (1919), which held that a manufacturer may unilaterally refuse to do business with dealers that decline to adhere to the manufacturer's suggested resale prices, has led to litigation over whether a manufacturer and a dealer can be said to have entered into an agreement on resale prices. This litigation focuses on issues of little or no economic significance, such as the quantity and quality of the communications between manufacturer and dealer, and has led to inconsistent and unpredictable results. *Dr. Miles* thus violates the principle that departures from the rule of reason must be based on demonstrable economic effects rather than formalistic line drawing.

Reconsideration of the proper antitrust analysis of vertical minimum resale price restraints is consistent with principles of *stare decisis*. In *Dr. Miles*, which was decided before this Court adopted the distinction between the rule of reason and the *per se* rule, there was evidence that the resale price restriction resulted from a horizontal price-fixing agreement among wholesale druggists. Moreover, the doctrine of stare decisis is not an inexorable command. The Court has overruled its statutory precedents where, as in this case, subsequent legal developments have removed the conceptual underpinnings of the prior decision. The usual rule that legislative changes should be left to Congress has less weight in cases interpreting the Sherman Act, because it has long been understood that Congress expected the

courts to draw on the common-law tradition to give meaning to the broad language of Section 1 of the Sherman Act. The Court has overruled its prior precedents with respect to vertical nonprice restraints and vertical minimum resale price maintenance; it should follow the same course with respect to vertical maximum resale price maintenance.

ARGUMENT

I. The *Per Se* Rule Is Reserved For Activities That Experience Has Shown Are Always, Or Almost Always, Anticompetitive.

"[T]his Court has long recognized that" Section 1 of the Sherman Act was "intended to outlaw only *unreasonable* restraints" of trade. *Texaco, Inc. v. Dagher*, 126 S. Ct. 1276, 1277 (2006), quoting *State Oil Co. v. Khan*, 522 U.S. 3, 10 (1997). *See also Business Electronics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717, 723 (1988). In determining whether a particular restraint is unreasonable, the Court's inquiry "is confined to a consideration of impact on competitive conditions." *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 690 (1978).

"Ordinarily, whether particular concerted action violates § 1 of the Sherman Act is determined through case-by-case application of the so-called rule of reason – that is, 'the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition.'" *Business Electronics*, 485 U.S. at 723, quoting *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49 (1977). The Court "presumptively applies rule of reason analysis." *Dagher*, 126 S. Ct. at 1279; *Business Electronics*, 485 U.S. at 726 (same).

In limited circumstances, the Court has departed from the rule of reason standard by holding that certain

categories of agreements are illegal *per se*, thus "dispensing with the need for case-by-case evaluation." *Business Electronics*, 485 U.S. at 723. The Court has reserved the *per se* rule for "'conduct that is manifestly anticompetitive,'" *i.e.*, conduct "'that would always or almost always tend to restrict competition and decrease output.'" *Id.*, quoting *Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-90 (1985), quoting, in turn, *Broadcast Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 19-20 (1979). The Court has explained that "[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable." *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982). In contrast, "'where the economic impact of certain practices is not immediately obvious,'" the Court has "'expressed reluctance to adopt *per se* rules.'" *Dagher*, 126 S. Ct. at 1279, quoting *State Oil*, 522 U.S. at 10, quoting, in turn, *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 458-59 (1986).

II. In *State Oil*, the Court Reexamined Vertical Maximum Resale Price Maintenance And Held That It Is Subject To The Rule of Reason Rather Than the *Per Se* Rule.

In *State Oil*, the Court reexamined its decision in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968), which held that vertical maximum resale price maintenance is subject to the *per se* rule. As a result of this reexamination, the Court unanimously held that vertical maximum resale price maintenance is properly analyzed under the rule of reason rather than the *per se* rule.

The Court's opinion in *State Oil* reviewed its decisions "leading up to and beyond" *Albrecht*. 522 U.S. at 10. The Court began with *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), which held that it was unlawful for manufacturers or suppliers to set

minimum resale prices to be charged by their distributors. The Court's opinion in *Dr. Miles* reasoned that suppliers should not be permitted to place "restraints upon alienation" of goods once title has passed to the dealer. 220 U.S. at 404. In *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 382 (1967), the Court extended this reasoning to vertical non-price restraints, holding that, "upon the transfer of title to goods to a distributor," a supplier's assignment of exclusive dealer territories is a *per se* violation of Section 1.

In *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the Court reconsidered its decision in *Schwinn*. The Court observed that "[t]he great weight of scholarly opinion has been critical of [*Schwinn*], and a number of the federal courts confronted with analogous vertical restrictions have sought to limit its reach." *Id.* at 47-49. The Court determined that "departure from the rule-of-reason standard must be based upon demonstrable economic effects rather than–as in *Schwinn*–upon formalistic line drawing." *Id.* at 58-59.[2]

Subsequent decisions of the Court "hinted that the analytical underpinnings of *Albrecht* were substantially weakened by *GTE Sylvania*." *State Oil*, 522 U.S. at 14. The Court recognized "that horizontal restraints are generally less defensible than vertical restraints," *Maricopa County*, 457 U.S. at 348 n.18. In addition, the Court observed that "a vertical restraint imposed by a *single* manufacturer or wholesaler may stimulate interbrand competition even as it reduces intrabrand

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[2] "The Court acknowledged the principle of *stare decisis*, but explained that the need for clarification in the law justified reconsideration of *Schwinn*." *State Oil*, 522 U.S. at 13, citing *GTE Sylvania*, 433 U.S. at 47-49. *See infra*, pp. 19-21 (discussing doctrine of *stare decisis*.)

competition." *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341-42 (1987).

The Court's analysis in *State Oil* was informed not only by its prior decisions, but also by the "considerable body of scholarship discussing the effects of vertical restraints," as well as the Court's "general view that the primary purpose of the antitrust laws is to protect interbrand competition." *State Oil*, 522 U.S. at 15, citing *Business Electronics*, 485 U.S. at 726. "So informed," the Court could not conclude "that vertically imposed maximum resale prices could harm consumers or competition to the extent necessary to justify their *per se* invalidation." 522 U.S. at 15.

In reaching this conclusion, the Court rejected "a number of theoretical justifications" for the *per se* rule of *Albrecht*. The *per se* rule had been defended on the ground that it promoted "dealer freedom," but the Court noted that it "actually prompted many suppliers to integrate forward into distribution, thus eliminating the very independent trader for whom *Albrecht* expressed solicitude." *Id.* at 16, quoting 9 P. Areeda, *Antitrust Law* ¶ 1635, p. 395 (1989). The Court also rejected the argument that the *per se* rule avoids situations in which "maximum prices may be set too low for dealers to offer consumers essential or desired services." 522 U.S. at 17. The Court observed that "such conduct, by driving away customers, would seem likely to harm manufacturers as well as dealers and consumers, making it unlikely that a supplier would set such prices as a matter of business judgment." *Id.* at 17 (citations omitted). The Court also rejected the argument that vertical maximum prices "channel distribution through large or specially advantaged dealers," noting that it is "unclear . . . that a supplier would profit from limiting its market by excluding potential dealers." *Id.* In addition, to the extent that maximum resale prices "might limit the viability of inefficient dealers, that consequence is not

necessarily harmful to competition and consumers." 522 U.S. at 17.

"After reconsidering *Albrecht*'s rationale and the substantial criticism the decision has received," the Court unanimously concluded "that there is insufficient economic justification for *per se* invalidation of vertical maximum price fixing." 522 U.S. at 18. Accordingly, the Court unanimously held that "vertical maximum price fixing, like the majority of commercial arrangements subject to the antitrust laws, should be evaluated under the rule of reason." *Id.* at 22.

III. Under Principles Recognized in *State Oil* and Other Decisions of this Court, Vertical Minimum Resale Price Maintenance Should Be Subject To The Rule of Reason Rather Than The *Per Se* Rule.

A. Vertical Minimum RPM Is Not Always, Or Almost Always, Anticompetitive.

There is widespread agreement among legal and economic scholars that vertical minimum resale price maintenance is not always, or almost always, anticompetitive.[3] To the contrary, minimum prices may

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[3] *See, e.g.*, 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶¶ 1620-1633 (2d ed. 2004); Roger D. Blair, Jill Boylston Herndon & John E. Lopatka, *Resale Price Maintenance and the Private Antitrust Plaintiff*, 83 Wash. U.L.Q. 657, 697-707 (2005); Robert H. Bork, *The Antitrust Paradox* 280-98 (1978); Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 423, 435-37 (4th ed. 2005); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere, Howard P. Marvel & James Peck, *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996); Frank H. (continued...)

actually enhance interbrand competition by ensuring that dealers provide the optimum level of service to consumers. Absent minimum price restraints, price-cutting dealers may free-ride on dealers that provide a higher degree of service to consumers. Such free-riding may make it difficult or impossible for dealers to provide the optimum level of service to consumers while remaining profitable.[4]

Minimum prices may enhance interbrand competition in a variety of ways. For example, they may encourage retailers to make investments in improving service to customers, such as training retail sales personnel and making physical improvements to retail locations.[5] Minimum prices may encourage dealers to stock larger quantities of a product, by eliminating concern that price-cutting by other dealers will decrease

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Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135 (1984); Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991); Richard A. Posner, *Antitrust Law* 172 (2d ed. 2001); W. Kip Viscusi, John M. Vernon & Joseph E. Harrington, Jr., *Economics of Regulation and Antitrust* 283 (4th ed. 2005); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 72 (1993). An experienced economist serving as an expert witness for Petitioner in this case stated: "I know of no economist who presently endorses a *per se* approach to either vertical price or non-price marketing practices that are unilateral and implemented by firms without market power." Pet. App. 40a.

[4] *See, e.g.*, Blair et al., *supra* note 3, at 698-700.

[5] *See, e.g.*, Carlton & Perloff, *supra* note 3, at 420-421.

the value of the inventory.[6] In addition, minimum prices may encourage dealers to provide shelf space to a new product, and thus may be a particularly effective way for new products and smaller competitors to gain a foothold with dealers.

The facts of this case indicate that the manufacturer's pricing strategy benefited consumers rather than harming them. Petitioner's sales increased significantly while its pricing policy was in effect, from 125,609 units in 1996 to 375,480 units in 2003. Pet. 3. Because Petitioner is a relatively small competitor with no market power, this substantial increase in sales strongly suggests that its marketing strategy coincided with consumers' preferences. Whether Petitioner's success resulted from inducing dealers to provide the optimum level of service, scarce shelf space, optimum levels of inventory, or for some other reason or combination of reasons, the policy appears to have benefited rather than harmed consumers and competition.

There is no persuasive reason to draw a sharp distinction between vertical price restraints and vertical nonprice restraints. Both types of vertical restraint generally reduce intrabrand competition while increasing interbrand competition. As the Court has explained, "all vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that. In fact, vertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the

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[6] *See, e.g.*, Deneckere et al., *Demand Uncertainty*, *supra* note 3, at 907-10.

dealer's profit margin permits provision of the desired services." *Business Electronics*, 485 U.S. at 727-29.[7]

At times, a manufacturer may be mistaken about the value of minimum resale prices. This should not be a matter of special antitrust concern, however, because such mistakes are likely to be self-correcting. A manufacturer has no incentive to impose minimum prices if doing so will reduce overall sales and profits, and thus has no reason to impose vertical price restraints unless they will induce the provision of dealer services that consumers want and are willing to pay for.

Under a rule of reason analysis, a court must consider (among other factors) whether the manufacturer or the dealer possess market power – *i.e.*, the power to profitably charge more than the competitive price for a product. It is important to note, however, that even if a manufacturer has market power, it is unlikely to adopt minimum resale prices as a device to achieve anticompetitive ends. A manufacturer with market power can exercise that power directly by charging a higher price to its dealers.[8] A manufacturer thus has no

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[7] The Court initially extended the *per se* rule to nonprice restraints as well as price restraints. *See Schwinn*, 388 U.S. at 379. When the Court concluded that subsequent experience justified overruling *Schwinn* and applying the rule of reason to vertical nonprice restraints such as exclusive dealer territories, it began a process that led to reexamination of vertical price restraints in *State Oil* and this case.

[8] The exercise of market power is not a violation of the antitrust laws, so long as the manufacturer's market power was lawfully obtained. *See United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (distinguishing "the willful acquisition or maintenance of . . . power" from "growth or development as a (continued...)

need to impose minimum resale price restraints to obtain the economic benefit of any market power it may possess.

To be sure, vertical minimum resale price maintenance may harm competition in some circumstances. For example, minimum resale price restraints may be used to facilitate a horizontal price fixing agreement at the dealer or manufacturer level. There is little evidence that this is a common occurrence, however. Moreover, horizontal price fixing – at any level of the chain of distribution – is a *per se* violation of the antitrust laws, and would remain so if *Dr. Miles* were overruled. *See, e.g., United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 223 (1940). In addition, vertical minimum resale price maintenance would remain subject to analysis under the rule of reason. Where rule-of-reason analysis indicates that the risk of anticompetitive harm outweighs the likely procompetitive benefits, vertical minimum price maintenance will be condemned.

B. The Court's Reasoning in *State Oil* Supports Reconsideration Of *Dr. Miles*.

This Court's reasoning in *State Oil* strongly supports the conclusion that vertical minimum resale price maintenance, like vertical maximum resale price maintenance, should be subject to the rule of reason rather than the *per se* rule.

First, State Oil (and other decisions of this Court) recognize that "any departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . formalistic line drawing." 522 U.S. at 14, citing *GTE Sylvania*, 433 U.S. at 58-59. The *per se* rule is limited to restraints that have "predictable and

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consequence of a superior product, business acumen, or historic accident.").

pernicious anticompetitive effect" coupled with "limited potential for procompetitive benefit." 522 U.S. at 10. The Court's legal analysis is informed by "scholarship discussing the effects of vertical restraints," as well as its recognition that "the primary purpose of the antitrust laws is to protect interbrand competition." *Id.* at 15, citing *Business Electronics*, 485 U.S. at 717. *See also Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 126 S. Ct. 1281, 1291 n.4 (noting that the Court's decision to abandon the presumption that a patent confers market power "accords with the vast majority of academic literature on the subject."). The overwhelming weight of scholarship supports the conclusion that vertical minimum resale price maintenance is not always, or almost always, anticompetitive, and thus should not be subject to the *per se* rule.

Second, the Court's reasons for rejecting the purported justifications for a *per se* rule against vertical maximum resale price maintenance (such as "dealer freedom," preventing dealers from offering the level of services that consumers demand, and preventing manufacturers from disadvantaging particular dealers, *see* 522 U.S. at 16-17) apply with equal force to the *per se* rule against minimum resale prices, and support the conclusion that all vertical resale price restraints should be subject to the rule of reason rather than the *per se* rule.

It is true, as the Court noted in *State Oil*, 522 U.S. at 15-16, that vertical maximum prices tend to hold down the prices charged to consumers. Vertical minimum prices, of course, tend to have the opposite effect. As explained above, however, vertical minimum prices, like vertical maximum prices, often enhance interbrand competition and thus benefit consumers. Consequently, this factor is not a sufficient basis for retaining the *per se* rule of *Dr. Miles* while overruling *Albrecht*.

C. The *Per Se* Rule of *Dr. Miles* Should Be Reconsidered Because Its Application Is Unpredictable and Turns on Economically Irrelevant Factors.

Shortly after the Court outlawed vertical minimum resale price maintenance in *Dr. Miles*, it held that a manufacturer has a right to select its dealers, and may unilaterally refuse to do business with dealers that decline to adhere to the manufacturer's suggested resale prices. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The Court's decision in *Colgate* mitigated the harmful economic effects of *Dr. Miles*, but at a cost. The interaction between *Dr. Miles* and *Colgate* has led courts to focus on whether manufacturers and dealers have entered into an agreement on resale prices that satisfies Section 1's requirement of a "contract, combination or conspiracy." Rather than considering the effect of the challenged restraint on consumers or competition, courts have concentrated on the nature and extent of communications between the manufacturer and the dealer. Litigation frequently focuses on whether manufacturers have engaged only in permissible price suggestions, or instead have crossed the line into impermissible "coercion" of dealers.[9]

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[9] Professors Areeda and Hovenkamp state that "courts have been bedeviled to determine which of [the following] practices constitutes or reflects an agreement" between a manufacturer and a dealer: (1) a manufacturer sells only to "congenial" dealers unlikely to discount prices and terminates dealers that prove uncongenial; (2) a manufacturer suggests resale prices that are widely followed; (3) a manufacturer announces and implements a policy of ceasing to supply dealers that sell below suggested resale prices; (4) a manufacturer implements a policy of ceasing to supply price-cutting dealers in a "complex" (continued...)

Similarly, manufacturers have long been permitted to set minimum prices on consignment sales, on the theory that there is no "restraint on alienation" where title to the goods has not passed from the manufacturer to the dealer. *See United States v. General Electric Co.*, 272 U.S. 476, 488 (1926) ("genuine contracts of agency" do not violate Section 1 because "the owner of an article, patented or otherwise" is not prohibited from "fixing the price by which his agents transfer title from him directly to [a] consumer"). This, in turn, has led to litigation over whether a particular arrangement is a "true" consignment. *See, e.g., Simpson v. Union Oil Co.*, 377 U.S. 13 (1964). Again, a focus on the terms of a particular

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manner; (5) a manufacturer exhorts dealers generally concerning resale prices, or threatens or negotiates with individual dealers, with or without an announced resale price policy; (6) a manufacturer ceases to supply a dealer after a complaint by another dealer about the terminated dealer's prices, or after the dealer "coerces" the manufacturer to terminate the price-cutting dealer; (7) the manufacturer conditions a reimbursement on resale prices; or (8) the manufacturer varies its price to the dealer based upon the dealer's resale price. 8 Areeda & Hovenkamp ¶ 1630, at 304-05. Areeda and Hovenkamp report that Situations 1 and 2 "are generally deemed not to create any agreement." *Id.* at 305. Although *Colgate* held that Situation 3 is not an agreement, the Court "seemed to retreat from that holding" in *United States v. Parke, Davis & Co.*, 362 U.S. 29 (1960), before reviving it in *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984). 8 Areeda & Hovenkamp at 305. *Monsanto* "does not foreclose finding an agreement in" Situations 4 and 5. *Id.* Situation 6 "has generally been held not to be an agreement" since *Monsanto*, "although the lower court decisions are not consistent." *Id.* Situations 7 and 8 "also have not brought consistent results." *Id.*

consignment arrangement ignores the actual economic effects of the challenged restraint on consumers in favor of formalistic considerations that are likely to be economically irrelevant.

While the boundary line between *Dr. Miles* and *Colgate* has remained fuzzy, it has shifted over time. In *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960), the Court held that the *Colgate* rule does not apply when the manufacturer takes "affirmative action to achieve uniform adherence" to its resale pricing policy. More recently, the Court has largely restored the scope of the *Colgate* doctrine. In *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 & n.9 (1984), the Court held that when a manufacturer terminates a price-cutting distributor following complaints from another distributor, no anticompetitive agreement may be inferred absent "evidence that tends to exclude the possibility that the manufacturer and nonterminated distributor were acting independently" and "reasonably tends to prove that the manufacturer and others had a conscious commitment to a common scheme designed to achieve an unlawful objective." And in *Business Electronics*, the Court held that an agreement between a manufacturer and one of its dealers to terminate a price-cutting dealer was not *per se* unlawful, so long as the manufacturer and the surviving dealer did not agree on resale prices. *See* 485 U.S. at 735-36.

Even after *Monsanto* and *Business Electronics*, the *per se* rule of *Dr. Miles* continues to require courts and lawyers counseling clients to focus on fact-intensive issues that are largely irrelevant to the actual economic effects of the challenged restraint. The focus on issues such as whether there is an agreement between manufacturers and dealers, whether dealers have been coerced, and whether there is a "true" consignment arrangement impose real costs by creating legal uncertainty and fostering expensive litigation. Moreover, the current legal

rules are directly contrary to the Court's recognition that "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than . . . upon formalistic line drawing." *GTE Sylvania*, 433 U.S. at 58-59. The interaction between *Dr. Miles* and *Colgate* thus provides an additional basis for re-examining the antitrust treatment of vertical minimum resale price maintenance and concluding that it should be analyzed under the rule of reason rather than the *per se* rule.

IV. Applying The Rule of Reason to Vertical Minimum RPM Is Consistent With Principles of *Stare Decisis*.

The Court decided *Dr. Miles* in 1911, before it had fully developed the distinction between the *per se* rule and the rule of reason. Moreover, there was evidence that the resale price restriction at issue in *Dr. Miles* may have resulted from a horizontal agreement among wholesale druggists. *See Areeda & Hovenkamp* ¶ 1620, at 211; Herbert Hovenkamp, *Enterprise and American Law, 1836-1937*, ch. 25 (1991). If so, the result in *Dr. Miles* (and the application of the *per se* rule to a *horizontal* price-fixing agreement among druggists) was correct, without regard to whether vertical minimum resale price maintenance is itself a *per se* violation of Section 1. That said, *Dr. Miles* has long been understood as adopting a *per se* rule against vertical resale price maintenance. *See, e.g., Business Electronics*, 485 U.S. at 724; *324 Liquor v. Duffy*, 479 U.S. at 341-43; *Monsanto*, 465 U.S. at 761. Even on that understanding, however, principles of *stare decisis* do not prevent the Court from reexamining the rule and bringing it into alignment with this Court's other decisions interpreting Section 1 of the Sherman Act.

The doctrine of *stare decisis* is a "principle of policy," *Helvering v. Hallock*, 309 U.S. 106, 119 (1940), not an "inexorable command." *Payne v. Tennessee*, 501 U.S. 808, 828 (1991). Although the Court generally is reluctant to overrule its statutory precedents, on the

ground that "Congress is free to change this Court's interpretation of its legislation," *Illinois Brick Co. v. Illinois*, 431 U.S. 720, 736 (1977), the Court has not hesitated to overrule its statutory precedents "when the intervening development of the law ha[s] 'removed or weakened the conceptual underpinnings from the prior decision, or where the later law has rendered the decision irreconcilable with competing legal doctrines or policies.'" *Neal v. United States*, 516 U.S. 284, 295 (1996), quoting *Patterson v. McLean Credit Union*, 491 U.S. 164, 173 (1989). As explained above, the conceptual underpinnings of *Dr. Miles* have been removed by the Court's subsequent decisions concerning vertical restraints, including *State Oil* and *GTE Sylvania*.

Moreover, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act in light of the accepted view that Congress 'expected the courts to give shape to the statute's broad mandate by drawing on common-law tradition.'" *State Oil*, 522 U.S. at 20-21, quoting *National Society of Professional Engineers v. United States*, 435 U.S. 679, 688 (1978). Indeed, as the Court has recognized, the statutory phrase "restraint of trade" in Section 1 of the Sherman Act "invokes the common law itself, and not merely the static content that the common law had assigned to the term in 1890." *State Oil*, 522 U.S. at 21, quoting *Business Electronics*, 485 U.S. at 732 (additional citations omitted). Many basic legal principles under Section 1 – including the distinction between horizontal and vertical agreements, the distinction between the *per se* rule and the rule of reason, and the principle that Section 1 forbids only unreasonable restraints of trade – were developed by this Court. The Court thus has been more willing to reconsider its Sherman Act precedents than it would be to reconsider other statutory precedents. *See, e.g.*, *State Oil*, 522 U.S. at 20-22 (reconsidering *per se* rule against vertical maximum resale price maintenance); *GTE Sylvania*, 433

U.S. at 47-57 (reconsidering *per se* rule against vertical territorial restrictions); *see also Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 126 S. Ct. at 1281, 1289-91 (reconsidering presumption that patents confer market power).[10]

Accordingly, the doctrine of *stare decisis* does not prevent the Court from reconsidering *Dr. Miles* and bringing the antitrust analysis of vertical minimum retail price maintenance into alignment with the Court's other precedents concerning vertical restraints.

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[10] Although Congress has legislated with respect to minimum resale price maintenance – first authorizing States to permit minimum resale price maintenance in the Miller-Tydings Act of 1937, Pub. L. No. 75-314, 50 Stat. 693, and the McGuire Act of 1952, Pub. L. No. 82-543, 66 Stat. 631 (1952), and then withdrawing that authorization in the Consumer Goods Pricing Act of 1975, Pub L. No. 94-145, 89 Stat. 801 – this series of legislative enactments should not be understood as freezing in place for all time this Court's decision in *Dr. Miles*. Rather, Congress's enactment and subsequent repeal of the Miller-Tydings and McGuire Acts leaves responsibility for interpreting Section 1 of the Sherman Act with this Court. *See* Easterbrook, *supra* note 3, at 139 ("The choice made in 1975 was to return RPM issues to the control of antitrust principles, free of state law, rather than to adopt a legislative rule specifying how to treat RPM."). The Court should apply the language of Section 1 to vertical minimum resale price maintenance in a way that is congruent with the interpretive principles this Court has developed and applied in other antitrust cases.

CONCLUSION

The decision of the court of appeals should be reversed.

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No. 06-480

In The

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., dba KAY'S KLOSET . . . KAY'S SHOES

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF FOR ANDERSON ECONOMIC GROUP, LLC AS AMICUS CURIAE SUPPORTING RESPONDENT

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QUESTION PRESENTED

Whether vertical minimum resale price maintenance agreements should be deemed per se illegal under Section 1 of the Sherman Act, 15 U.S.C. § 1, or whether they should instead be evaluated under the rule of reason.

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INTEREST OF ANDERSON ECONOMIC GROUP

Anderson Economic Group, LLC is an economics consulting firm in East Lansing, Michigan and Chicago, Illinois. Antitrust economics is a specific area of expertise of the firm. Principal Patrick L. Anderson and Senior Economist Ilhan K. Geckil have provided expert testimony and consulting services in the area of antitrust economics, and have authored scholarly articles and expert reports addressing antitrust economics issues. Mr. Anderson is also the author of a textbook on business economics. Theodore R. Bolema is a consultant affiliated with the Anderson Economic Group antitrust economics practice and was a trial attorney with the Antitrust Division of the U.S. Department of Justice for eight years. The firm has consulted for both franchisors and franchisees in the automotive, alcoholic beverage, and other industries in which vertical arrangements are common. Anderson Economic Group submits this brief to provide practical insights from their professional experience on the question presented in this case, and propose an approach to evaluating minimum resale price maintenance that would maintain some form of per se treatment.[1]

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[1] This brief is filed with the consent of all parties, who have filed letters of consent with the Clerk. No counsel for a party authored the brief in whole or in part, nor did any person or entity, other than amicus curiae and its counsel, made a monetary contribution to the preparation or submission of this brief.

SUMMARY OF THE ARGUMENT

Some form of a per se rule for minimum resale price maintenance ("RPM") policies should be preserved.

A. The Supreme Court recognizes that per se rules offer important economic efficiency benefits.

B. The Court does not have to choose between the extremes of maintaining full per se illegality for minimum RPM, or subjecting all RPM practices to rule of reason analysis. The Court has applied "quick look" variations for a range of other practices that may violate the antitrust laws.

C. By definition, minimum RPM is intended to maintain prices at levels higher than would prevail in the absence of the RPM policy. Thus, the anti-competitive potential for limiting competition at the retail level and reducing consumer welfare is obvious.

D. Various forms of price, quality, and quantity discipline in "vertical" arrangements offer pro-competitive benefits, some of which may be significant. However, the mere existence of consumer benefits does not eliminate the benefits to those same consumers of clearly condemning practices that are hard to detect, harder still to prove, and which rarely provide benefits that outweigh the harm.

E. Our practical experience in consulting in industries in which "vertical" arrangements are common underscores both the benefits of some communication about prices and products within a franchise, and the risks of allowing discipline to escalate to price-fixing and market allocation of the type the per se rule was originally intended to discourage.

F. Our practical experience also underscores the difficulty in detecting and proving collusion, even when

the facts clearly establish that collusion took place. Those that practice collusion have a much easier time covering their tracks than those suspecting it have of proving it.

G. Newer technology now allows real-time pricing and inventory information to be shared among franchisees and franchisors, thus magnifying the potential scope and harm of RPM policies.

H. Anti-competitive minimum RPM, if allowed to lapse into the "rule of reason" analysis, would often go undetected, and would be far less likely to be deterred, than under the per se rule.

ARGUMENT

THIS COURT SHOULD NOT SUBJECT ALL RESALE PRICE MAINTENANCE TO THE RULE OF REASON

In *Dr. Miles Med. Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911) ("*Dr. Miles*"), this Court ruled unlawful a vertical agreement between a medicine supplier and wholesalers and retailers regarding the minimum price at which the medicines could be resold. The ruling in the *Dr. Miles* case has generally been understood as having established a per se rule against RPM. *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51 n.18 (1977); *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 733 (1988); *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 133 (1998).

In the last two decades, the Court has narrowed the scope of the per se rule for some vertical agreements other than minimum RPM, based on developments in economic analysis. In *Continental T.V., Inc. v. GTE Sylvania, Inc.*,

433 U.S. 36 (1977) ("*Sylvania*"), the Court ruled that vertical non-price agreements would be subject to a rule of reason analysis. In *State Oil Co. v. Khan,* 522 U.S. 3 (1997), the Court ended the per se prohibition against maximum price-fixing agreements. This Court has not, however, overruled the per se treatment of minimum resale price maintenance, which raises more obvious anti-competitive concerns than non-price or maximum RPM practices.

While the Court should consider clarifying the standard to be applied to minimum RPM to reflect recent economic developments, proving a minimum RPM violation should not require in every situation that the plaintiff prove a full rule of reason case.

A. Per Se Rules In General Offer Important Economic Efficiency Benefits

Section 1 of the Sherman Act, 15 U.S.C. § 1, declares every "contract, combination . . . , or conspiracy, in restraint of trade . . . to be illegal." This broad language suggests that all concerted activity that restrains trade is illegal. In developing the standards for interpreting the Act, this Court has consistently interpreted Section 1 as condemning only unreasonable restraints of trade. In doing so, this Court has identified certain conduct as illegal per se, and has required that other conduct be evaluated under a rule of reason, based on the effects under the specific circumstances before the Court.

The Court has noted that "certain kinds of agreements will so often prove so harmful to competition and so rarely prove justified that the antitrust laws do not require proof that an agreement of that kind is, in fact, anti-competitive

in the particular circumstances." *NYNEX Corp. v. Discon, Inc.*, 525 U.S. at 133. For example, in *FTC v. Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 432-36 (1990), a group boycott aimed at raising the compensation for public defenders was found per se unlawful after little consideration of market power or the defendant's justifications.

Choosing between a per se rule, a rule of reason, or something in between requires that the Court make tradeoffs. A per se rule sacrifices some accuracy by condemning some conduct as anti-competitive that a more careful review would find reasonable. In exchange, however, a per se rule offers important benefits.

1. A per se rule lowers the cost of antitrust litigation

Antitrust trials under the rule of reason are complicated and expensive to litigate. A per se rule condemns a category of conduct without requiring that the plaintiff (i) prove that the defendant possesses market power, (ii) prove an unreasonable outcome, such as higher prices or reduced output, and (iii) rebut the defendant's justifications. "This principle of per se unreasonableness not only makes the type of restraints which are proscribed by the Sherman Act more certain to the benefit of everyone concerned, but it also avoids the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable – an inquiry so often wholly fruitless when undertaken." *Northern Pacific Ry. v. United States*, 356 U.S. 1, 5 (1958). "Cases that do not fit the generalization may arise, but a per se rule

reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them." *Sylvania,* 433 U.S. at 50 n.16.

2. A per se rule also provides clearer guidance to business decisionmakers

"[P]er se rules tend to provide guidance to the business community and to minimize the burdens on litigants and the judicial system of the more complex rule-of-reason trials. . . ." *Sylvania*, 433 U.S. at 50 n.16. "For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a fullblown inquiry might have proved to be reasonable." *Arizona v. Maricopa County Med. Soc'y,* 457 U.S. 322, 344 (1982).

The Antitrust Division and the Federal Trade Commission use a similar approach to providing such guidance in their various statements on their enforcement of the antitrust laws. For example, the agencies' Statements of Antitrust Enforcement Policy in Health Care describes its use of "safety zones" as follows: "The safety zones are designed to require consideration of only a few factors that are relatively easy to apply, and to provide the Agencies with a high degree of confidence that arrangements falling within them are unlikely to raise substantial competitive concerns." U.S. Department of Justice and Federal Trade Commission, *Statements of Antitrust Enforcement Policy in Health Care*, 4 Trade Reg. Rep. (CCH) ¶13,153 (August 18, 1996).

3. Per se rules deter unreasonable conduct that would otherwise go unchallenged

Per se rules also deter conduct that would be found unreasonable, but which would be allowed to continue because the costs and risks of litigation outweigh the benefits to private parties to litigate the matter through a full rule of reason analysis. Many RPM cases, including the present case, are brought by private parties. The costs to plaintiffs of proving harm under a rule of reason standard are far greater than the costs under a per se rule. The Court should recognize that a shift to rule of reason treatment for all RPM would allow some anti-competitive conduct to persist because the cost and risks of litigating the claim outweigh the economic benefits to the private parties bringing the litigation.

Moreover, any lost competitive benefits to a supplier prevented by a per se rule from engaging in a certain potentially pro-competitive practice in many cases may be mitigated when the supplier has available alternative strategies subject to a rule of reason that may achieve most or all of the same benefits. In the case of minimum RPM, many of the same competitive benefits may be achieved in the form of vertical non-price restraints that are subject to the rule of reason.

B. The Court Has Applied Rules In Between the Per Se Rule and Rule of Reason

Although this analysis is often described as a dichotomy between per se and rule of reason cases, the Court has applied standards that are a mix of rule of reason and per se rules. The result is that the choice between the per se rule and the rule of reason approaches has become "less a

dichotomy than a continuum." *National Collegiate Athletic Ass'n v. Board of Regents of the Univ. of Oklahoma*, 468 U.S. 85, 110 n.39 (1984) ("*NCAA*"), quoting Phillip Areeda, *The "Rule of Reason" in Antitrust Analysis: General Issues* 37-38 (Federal Judicial Center, June 1981).

NCAA involved limitations on the number of college football telecasts. The Court refused to apply per se treatment because the case "involves an industry in which horizontal restraints on competition are essential if the product is to be available at all." *NCAA* at 101. The Court then rejected requiring the plaintiff to meet the rule of reason requirement of proving market power. "As a matter of law, the absence of proof of market power does not justify a naked restriction on price or output. To the contrary, when there is an agreement not to compete in terms of price or output, 'no elaborate industry analysis is required to demonstrate the anticompetitive character of such an agreement.'" *NCAA* at 101, quoting *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 692 n.39 (1978).

A quick look was later applied in *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447 (1986), which involved an agreement to refuse to supply x-rays to insurers who would use the x-rays to evaluate benefit claims. The Court did not apply per se analysis because a rule of the professional association was "imposed in the context of business relationships where the economic impact . . . is not immediately obvious." *Id.* at 458-59. The Court instead used a quick look version of the rule of reason and condemned the conduct without "elaborate industry analysis." *Id.* at 459. Thus, the plaintiff's burden of proving a full rule of reason claim was greatly reduced. The defendants were

allowed to present pro-competitive justifications, but these defenses were not found to be persuasive.

Quick look analysis condemns a certain category of restraints on competition without requiring the plaintiffs to prove market power or disprove possible defenses, while giving defendants an opportunity to present pro-competitive defenses. A quick look was also employed by the Court in *Broadcast Music, Inc. v. Columbia Broadcasting System*, 441 U.S. 1 (1979) ("*BMI*"), and in that case the Court accepted the pro-competitive arguments of the defendants.

The cases in which the Court applied a quick look have focused on whether the category of conduct involved "naked" restraints that limit competition on price or restrict output. A plaintiff is allowed to make a prima face case to establish a presumption of anti-competitive harm due to the nature of the conduct in the particular category. The burden then shifts to the defendant to demonstrate a pro-competitive justification. "Absent some countervailing procompetitive virtue – such as, for example, the creation of efficiencies in the operation of a market or the provision of goods and services – such an agreement limiting consumer choice by impeding the 'ordinary give and take of the market place,' cannot be sustained under the Rule of Reason." *FTC v. Indiana Fed'n of Dentists* at 459, quoting *National Soc'y of Prof'l Eng'rs v. United States*, at 692.

C. Minimum RPM Raises Significant Competitive Concerns

By definition, minimum RPM is intended to maintain prices at levels higher than would prevail in the absence of the RPM policy. Thus, the anti-competitive potential for

limiting competition at the retail level and reducing consumer welfare is obvious. As this Court noted in *Sylvania*, "[U]nlike nonprice restrictions, '[r]esale price maintenance is not only designed to, but almost invariably does in fact, reduce price competition not only among sellers of the affected product, but quite as much between that product and competing brands.'" *Sylvania*, at 51 n.18 (citation omitted).

RPM may also lead to inframarginal customers paying more for a product they would have purchased in any event, regardless of any promotional services offered by the resellers. William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 990-91 (1985).

Moreover, as Pitosky noted, "Another anticompetitive effect of vertical price fixing is that the manufacturer may tend to stabilize minimum prices at the *manufacturer's* level. . . . Since their dealers cannot pass along the price cut to consumers, the dealers will pocket the manufacturer's price reduction – and hence the price reduction at the manufacturer level is much less likely to occur at all." Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1490-91 (1983) ("Pitofsky").

Thus, the Court has rightly been concerned about the anti-competitive harm of minimum RPM in cases in which it has applied per se condemnation. The question the Court raises is a question of how to balance the benefits and costs of alternative approaches to evaluating minimum RPM.

D. The Mere Existence of Consumer Benefits Does Not Eliminate the Legitimate Role of a Per Se Rule

Various forms of price and supply discipline in "vertical" arrangements may also offer pro-competitive benefits, some of which may be significant. In particular, franchisors and franchisees may provide better service to consumers, while enhancing the value of the brand network, by agreeing on quality standards for products, providing after-sale service at reasonably predictable prices, releasing new versions of products when adequate supplies are available across a wide market, and sharing the costs of advertising in local markets.

However, nearly every type of anti-competitive action has been justified at one time or another with a claim of consumer benefits. Even naked restraints of trade have the "benefit" of saving consumers the time and effort of choosing the best product for themselves. The Court has long refused to recognize such claims regarding naked agreements on prices. *United States v. Trenton Potteries,* 273 U.S. 392, 397-98 (1927); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224-26 (1940); *Goldfarb v. Virginia State Bar*, 421 U.S. 773, 782 (1975).

The mere existence of consumer benefits does not eliminate the benefits to those same consumers of condemning practices that are hard to detect, harder still to prove, and which rarely provide benefits that outweigh the harm.

E. Franchises Already Have Mechanisms of Control and Communication That Provide the Same "Benefits" Asserted for Minimum RPM

Our practical experience in consulting in industries in which "vertical" arrangements are common provides important insights into the degree of control and communication that already occurs in these industries, even without minimum RPM. These industries include automobiles, trucks and motorcycles, rental cars, beer, wine and spirits, and medical examinations. In each of these, franchise arrangements predominate.

A true franchise exists when one business entity (the "franchisor") provides certain services to, and exercises a small amount of control over, a range of other entities ("franchisees"), in return for a fee.[2] Franchises are different from simple resale agreements in that the franchisor and

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[2] The three essential characteristics of a "franchise" system are:

Trademark. The franchisor creates a brand identity for a product or service. This brand identity normally includes products or services that bear a trademarked symbol or name.

Significant Control. The franchisor exercises significant control over the franchisees operations. This typically includes following certain standards for representing the brand, and for service and product delivery.

Required Payment. In return for the use of the trademarked product or service, and other benefits of being part of the franchise system, the franchisee pays a fee, royalty, or other amount to the franchisor.

The FTC franchise rule is an example of a definition of franchise that relies on these three factors. See *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, effective October 21, 1979, at 16 C.F.R. Part 436, available at http://www.ftc.gov/bcp/franchise/netrule.htm.

franchisee share some business risk and seek to create value for themselves by better serving the consumers.[3]

Our experience in franchised industries underscores both the benefits of some communication about prices and products within a franchise, and the risks of allowing such communication and discipline to escalate to price-fixing and market allocation of the type the per se rule was originally intended to discourage.

These benefits are the same benefits that are asserted by proponents of rule of reason treatment of minimum RPM. Consumers receive more consistent service and product quality, and reduce their search costs, by relying on "brand" identity to guide them.

For example, consumers interested in purchasing luxury vehicles look at Cadillac, Mercedes-Benz, Lincoln, and other such dealers, and not at the Saturn or Scion dealers. Dealers also have the incentive to promote the brand in order to promote their own sales, and manufacturers often provide funds to assist dealers in promoting both the brand and their own dealership. However, despite the existence of suggested retail prices for these vehicles (required by federal law to be displayed on each vehicle in a showroom), dealers and consumers are free to negotiate prices. Indeed, such negotiation is vigorous, and the

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[3] The unique valuation issues raised by franchises are discussed in Patrick L. Anderson, *Business Economics and Finance*, CRC Press, 2004. See also Roger Blair and Francine Lafontaine, *Economics of Franchising*, Cambridge Univ. Press, 2005, which discusses pricing arrangements within franchises.

consumer has benefited greatly from competition among manufacturers and their dealer networks.[4]

The experience of price competition in the automobile industry, even with significant franchisor control over franchised dealers, is one that also prevails in other industries. Blair and Lafontaine report that five separate empirical studies demonstrate variations in price even among strong fast-food franchises in local areas. Roger Blair and Francine Lafontaine, *Economics of Franchising,* Cambridge, 2005. They also cite McDonald's corporation's public statements about variation in prices among their individually-owned franchises, stating "as independent businesspeople, each individual determines his or her own prices taking into account their operating costs and the company's recommendations into consideration." McDonald's Corporation, *Standards of Business Conduct for Employees*, available at http://www.mcdonalds.com/corp/invest/gov/standards_of_business.html.[5]

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[4] Indeed, the quality-adjusted price of new vehicles in the United States has actually *declined* in recent years, according to the U.S. Bureau of Labor Statistics. For example, an urban consumer in the Midwest who spent $10,000 on a new car or truck in 1997 could purchase the same quantity and quality for just $9,351 in 2006. See United States Bureau of Labor Statistics, *EconStats*, series CPI Midwest urban new cars and trucks; available at http://www.econstats.com/BLS.

[5] The company's *Standards of Business Practice* explicitly prohibit "Entering into any formal or informal agreement or understanding with competitors that fixes, controls or affects prices, products, terms of sale, costs, profits or profit margins, markets or market share, or distribution practices." McDonald's Corporation, *Standards of Business Conduct for Employees*, available at http://www.mcdonalds.com/corp/invest/gov/standards_of_business.html.

These two industries, both of which directly serve tens of millions of consumers annually, demonstrate that communication among vertically-organized distribution systems, adherence to quality standards, reasonably predictable prices for identifiable products, and other consumer benefits are already available under the current per se prohibition of minimum price RPM.

F. Collusive Agreements Are Often Difficult to Prove

Our practical experience also underscores the difficulty in detecting and proving collusion, even when the facts clearly establish that collusion took place. Even under ideal circumstances, the price and quantity information that might be obtained are often insufficient to adequately prove collusion. As demonstrated by Anderson, an ideal data set consisting of accurate data on prices provided by multiple providers, on comparable products, at regular dates, with no changes in underlying economic conditions, may not be enough to demonstrate beyond reasonable doubt collusion using normal statistical methods. Patrick L. Anderson, *Damages in Antitrust Cases*, Anderson Economic Group working paper 2007-2, available at http://www.andersoneconomicgroup.com. A recent review of antitrust litigation by Molly L. Zohn concluded that "antitrust damage estimation in one area of law wherein courtroom statistical evidence has failed to keep pace with statistical advances in the field." Molly L. Zohn, *How Antitrust Damages Measure Up with Respect to the Daubert Factors*, Geo. Mason Law Review (13:3), 2005.[6]

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[6] Zohn discusses specifically two methods of calculating damages, the "before and after" and "yardstick" method, and concludes that

(Continued on following page)

G. New Technology Magnifies Potential Damage of RPM Schemes

New technology now allows real-time pricing and inventory information to be shared among franchisees and franchisors, thus magnifying the potential harm of minimum RPM. The practice of "yield management" or "revenue management," which gained visibility in the airline industry, is particularly noteworthy. By collecting information on prices and available quantities, yield management systems allow a seller or group of sellers to charge different prices depending on the availability of substitutes. Airline travelers are familiar with the large variation in prices charged to passengers sitting on the same plane, often in adjoining seats. It is the explicit goal of such "yield management" practices to charge *higher* prices to those travelers – such as business travelers that must travel on short notice during the workweek – who have fewer substitutes.

The existence of a per se rule against minimum RPM deters this practice from becoming a high-tech collusion device in the industries in which it is used. The specter of yield management in at least one other industry – cruise ships – has already drawn some scrutiny from the FTC in the *Royal Caribbean Cruises-Princess Cruises* merger review.[7]

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neither meet both the legal standards that might be applied under *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and the standards of professional practice used by econometricians.

[7] Federal Trade Commission, In the matter of Royal Caribbean Cruises, Ltd./P&O Princess Cruises plc and Carnival Corporation/P&O Princess Cruises plc; File No. 021 0041, available at http://www.ftc.gov/os/caselist/0210041.htm.

H. The Court Should Not Completely Abandon Per Se Condemnation of Minimum RPM

William E. Cohen of the Federal Trade Commission proposed an approach for identifying horizontal restraints that are appropriate for a quick look analysis, but which also could be applied to minimum RPM. Under Cohen's approach, conduct appropriate for a quick look approach would be identified by asking "whether a restraint by its nature can be presumed to harm competition. In other words, it would ask whether a restraint is of a type traditionally condemned as per se unlawful or is so seriously anticompetitive that it becomes a candidate for truncated treatment. The inquiry might be whether the restraint limits competition on price or output or some variant thereof . . . so long as the language identifies conduct within or sufficiently close to current per se boundaries to support the necessary presumption of competitive harm." William E. Cohen, *Per Se Illegality and Truncated Rule of Reason: The Search for a Foreshortened Antitrust Analysis,* FTC Policy Planning Staff Discussion Draft, Section III(A)(3) (Nov. 1997), available at http://www.ftc.gov/opp/jointvent/persepap.htm.

Minimum RPM, based on its history of per se treatment and continuing potential for anti-competitive harm, is an appropriate candidate for quick look treatment, if the Court does not continue per se condemnation.

Under such a "quick look" review, once conduct is identified as minimum RPM, the defendant would be given the opportunity to present competitive justifications. Economic analysis describes a number of situations in which RPM may promote rather than impede competition. Thus, for example, the defendant could show that the specific minimum RPM employed by the defendant may stimulate

interbrand competition by encouraging resellers to promote the product, and may prevent resellers from free-riding off promotional activities of their horizontal competitors.

If the court finds those justifications persuasive, then the plaintiff would lose the benefit of presumption of competitive harm, and would be required to prove a rule of reason case to prevail. If the defendant cannot demonstrate pro-competitive justifications, then the plaintiff would not be required to show market power and demonstrate anti-competitive harm.

As Pitofsky concluded,

> "Allowing occasional exceptions is not inconsistent with per se treatment. The justification for a per se approach is that minimum price fixing is often a response to dealer pressure, detecting that fact is extremely difficult, the effects at the dealer level (and occasionally the manufacturer level) are highly anticompetitive, and the purported business justifications of those arrangements can usually, if not always, be achieved in some less restrictive way. Limited and carefully defined exceptions are a way of preserving efficient enforcement while accommodating those relatively few situations that merit more extended analysis."

Pitofsky, at 1495.

There still remain situations where anti-competitive minimum RPM practices can be identified without a full rule of reason analysis. For these situations, per se treatment of minimum RPM still promotes competition, and some form of per se treatment should continue.

CONCLUSION

The judgment of the court of appeals should be upheld or modified to preserve per se condemnation of minimum resale price maintenance as the general rule while allowing exceptions for pro-competitive efficiencies.

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No. 06-480

In The
Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as
KAY'S KLOSET . . . KAY'S SHOES,

Respondent.

**On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit**

BRIEF OF BURLINGTON COAT FACTORY WAREHOUSE CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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BRIEF OF BURLINGTON COAT FACTORY WAREHOUSE CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF AMICUS CURIAE

Burlington Coat Factory Warehouse Corporation ("Burlington Coat Factory") operates a nationwide chain of "off price" retail stores that offer consumers designer and brand-name clothing, shoes, and household merchandise at prices substantially lower than large department stores, its principal competitors. Like many other discount retailers, it has long relied on the legally mandated absence of price-fixing agreements in the vertical chain of product distribution.

Some twenty years ago, Burlington Coat Factory filed a brief as an *amicus curiae* in *Monsanto Co. v. Spray-Rite Service Corp.*, 465 U.S. 752 (1984), urging the Court to decline the Justice Department's invitation to overrule *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). Burlington Coat Factory again appears before the Court as an *amicus curiae* to urge the Court not to overrule that nearly century-old precedent for the same reason it did in *Monsanto*: The elimination of the per se rule against vertical price-fixing will likely subject it, along with many other discount retailers, to the harmful effects of manufacturer- and distributor-imposed minimum price requirements.[1]

[1] Burlington Coat Factory affirms that no party's counsel wrote this brief (in whole or in part) and that no person other than it and its counsel contributed monetarily to this brief's preparation or submission. The parties' letters consenting to the filing of this brief have been lodged with the Clerk of the Court.

SUMMARY OF ARGUMENT

The issue in this case is not whether, as an original matter, modern economic analysis justifies the per se treatment of vertical price-fixing. The issue is whether the Court should now overturn the per se rule governing vertical price-fixing adopted nearly a century ago in *Dr. Miles*, maintained in the Court's decisions ever since, and, in recent decades, strongly endorsed by Congress. We submit that none of the economic arguments offered for overruling *Dr. Miles*, whatever their (questionable) underlying merits, outweighs the competing *stare decisis* considerations. Prominent among those considerations is the long-standing commercial reliance of discount retailers on the per se rule as an important component of retail market regulation.

ARGUMENT

The Court Should Not Overrule *Dr. Miles*

We leave to Respondent and the other *amici* (especially the American Antitrust Institute) the important task of briefing the compelling doctrinal, economic, and other policy considerations that warrant continued adherence to *Dr. Miles*' long-standing per se rule against vertical price-fixing. See Brief of American Antitrust Institute ("AAI Br."). Our focus is more limited. We urge the Court to give decisive weight to the doctrine of *stare decisis* in this case and, in particular, to recognize the reliance of discount retailers like Burlington Coat Factory on the per se rule. See *infra* § A. In doing so, we also respond briefly (from the perspective of discount retailers) to Petitioner's main argument as to why vertical price-fixing should be freed from per se condemnation: namely, that it is the only

efficient response to the so-called "free-rider" problem. See *infra* § B.

A. *Stare Decisis* Demands Adherence to *Dr. Miles*

1. *Dr. Miles* has governed the law of vertical price-fixing for nearly a century – indeed, for almost the entire life of the Sherman Act. The Court has never called into question *Dr. Miles*' core holding that an agreement to fix a minimum price in the vertical chain of distribution is per se illegal. The Court has, to the contrary, consistently and repeatedly left *Dr. Miles*' core holding intact, even as the Court has refused to extend it, and twice retreated from its extension, to other contexts. When the Court overruled *United States v. Arnold, Schwin & Co.*, 388 U.S. 365 (1967), in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), and thereby removed non-price vertical restraints from the per se rule, it emphasized that its analysis had no bearing on and did not upset the "firmly" "established" rule governing vertical price-fixing. *Id.* at 52 n.18. A decade later when the Court revisited vertical non-price restraints in *Business Electrics Corp. v. Sharp Electronics Corp.*, 485 U.S. 717 (1988), the Court again took care to emphasize the different footing on which vertical price restraints stand. See *id.* at 725-26. Important to the Court's refusal in *Sharp* to condemn under the per se rule a vertical agreement between a manufacturer and a dealer to cut a second, price-cutting dealer was the clear absence of a "further agreement on the price" to be charged by the surviving dealer. *Id.* at 726. *State Oil Co. v. Khan*, 522 U.S. 3 (1997), the Court's most recent pronouncement on the subject, is in accord. In holding that the per se rule does not condemn vertical *maximum* price maintenance agreements, the Court again made clear that

"arrangements to fix minimum prices . . . remain illegal *per se*." *Id.* at 17. The Court rejected only its earlier extension of the per se rule to maximum resale price maintenance agreements in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). See *Khan*, 522 U.S. at 15-19. See also *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 n.7 (1984) (declining the Department of Justice's invitation to overrule *Dr. Miles*). See generally AAI Br. § I(A) (citing other cases).

Congress, for its part, has stood firmly behind *Dr. Miles*' per se rule during the last few decades as it has no other principle of antitrust law. In the 1970's, Congress revoked the authority it had earlier conferred on the states to exempt certain price-fixing agreements (unlawful under *Dr. Miles*) from coverage under the Sherman Act; in the 1980's, it twice denied the Department of Justice funds to advocate (as the Department was then intent on doing) for the overruling of *Dr. Miles*; and in the 1990's, both the House and Senate passed bills codifying the per se treatment of vertical price-fixing adopted in *Dr. Miles*. See Respondent's Certiorari-Stage Brief in Opposition ("Resp. Cert.-Stage Br.") at 12-13; Brief for Petitioner ("Pet. Br.") at 33-36; Brief for United States ("SG Br.") at 21-22. Petitioner responds by noting that Congress has never actually *required* the Court's adherence to the per se rule. See Pet. Br. at 33-35. Accord SG Br. at 21. That is true, but irrelevant. The question is not whether Congress has mandated the per se rule, but whether it has expressed its position as to how the Sherman Act should be interpreted on the particular issue of vertical price-fixing. The answer is that it has – repeatedly, unmistakably, and authoritatively. See AAI Br. § I(A). See also Herbert Hovenkamp, *Chicago and Its Alternatives*, 1986 Duke L.J. 1014, 1020 n.34 ("I am persuaded . . . that Congress sanctioned the per

se rule for resale price maintenance, and that we should feel obliged to comply with it until Congress tells us otherwise.").

2. We emphasize Congress' actions not merely because they reflect Congress' clear intent on an important question of statutory interpretation to which the Court should give *dispositive weight*, see AAI Br. § II(B), but also because they, together with the above-cited decisions, form an essential part of the regulatory background against which Burlington Coat Factory and many other discount retailers have financed, structured, and operated their businesses. The reliance of discount retailers on *Dr. Miles* needs no elaborate demonstration. Even critics of *Dr. Miles* have noted that, among business interests, discount retailers stand the most to lose from the introduction of price-fixing into the vertical chain of product distribution. See, *e.g.*, Robert H. Bork, *The Antitrust Paradox* 436 (rev. ed. 1993). Petitioner fails to acknowledge the settled commercial expectations of discount retailers – not to mention those who invest in them, contract with them, and patronize them – in asking the Court to overrule *Dr. Miles*. We urge the Court to give these obvious reliance interests the weight to which they are entitled under the Court's well-established *stare decisis* case law. See, *e.g.*, *Hubbard v. United States*, 514 U.S. 695, 713 (1995).

3. Neither Petitioner nor the Solicitor General ultimately reckons with the claim that *stare decisis* has on the resolution of this case. Petitioner, for its part, has relegated its discussion of *stare decisis* to two paragraphs at the very end of its brief. See Pet. Br. at 32. The Solicitor General is only a little more solicitous of the doctrine in

his brief. See SG Br. at 24. A settled and Congressionally sanctioned policy that has regulated retail pricing policy for nearly a century deserves much more respect than either Petitioner on the Solicitor General accords it. See AAI Br. at I(A).

Petitioner and the Solicitor General justify their dismissive stance toward *stare decisis* by claiming that the doctrine applies with somewhat diminished force in the antitrust context because Congress has delegated to the courts the responsibility for developing antitrust policy and adopting antitrust law to changed circumstances. See Pet. Br. at 32; SG Br. at 24-25. That argument, whether or not persuasive as a general matter, is not at all persuasive in the particular context of vertical price-fixing. Congress has actively legislated in this area as it has in few, if any, other areas of antitrust policy – first in the 1930's and 1950's when it authorized states to exempt certain price-fixing agreements (unlawful under *Dr. Miles*) from coverage under the Sherman Act, then in the 1970's when it revoked that authorization, then in the 1980's when it specifically denied the Department of Justice funds to advocate the overruling of *Dr. Miles*, and most recently in the 1990's when it endorsed the per se rule in several bills. See Resp. Cert.-Stage Br. at 11-14. See also AAI Br. § II(A). A 1991 House of Representatives' report noted that, "[w]ith the possible exception of merger policy, *there is no area of antitrust where Congress has displayed such an explicit and abiding intent to set policy for the courts* and enforcement agencies as the area of resale price maintenance." H.R. Rep. 102-237, 102nd Cong., 1st Sess. 4 (1991) (emphasis added).

In any event, Petitioner and the Solicitor General greatly exaggerate the diminished force that *stare decisis*

has in antitrust cases. See AAI Br. § I(B). This Court has taken far more seriously the role of *stare decisis* in antitrust cases than Petitioner and the Solicitor General would have the Court believe. See *id.* It has recognized, in particular, what is of principal concern to Burlington Coat Factory in this case: that antitrust law implicates important reliance interests involving contractual relationships and property rights that should not be cast aside without compelling justification. See, *e.g.*, *Khan*, 522 U.S. at 20.

4. The two vertical distribution cases Petitioner cites in which the Court did overrule precedent – *Schwin* (overruled in *GTE Sylvania*), which established a per se rule for non-price vertical restraints and *Albrecht* (overruled in *Khan*), which established a per se rule for maximum price-fixing agreements – stood on different footing than *Dr. Miles*. Both, when overruled, were recent decisions. *Schwin* was not decided until 1967 – just four years after the "Court had refused to endorse a per se rule for vertical restrictions," *GTE Sylvania*, 433 U.S. at 47, in *White Motor Corp. v. United States*, 372 U.S. 253 (1963) – and *Albrecht* not until 1968. *Dr. Miles*, it bears emphasis, is nearly a century old.

Dr. Miles is distinguishable from *Schwin* and *Albrecht* in still more important ways. *Schwin* created confusion and uncertainty among lower courts as to which (non-price) vertical restraints were lawful and which unlawful. See *GTE Sylvania*, 433 U.S. at 47-48. It was precisely the "need for clarification of the law" governing non-price vertical restraints that the Court cited in *GTE Sylvania* as its justification for reconsidering *Schwin*. See *id.* at 47. *Albrecht* had "little or no relevance to ongoing enforcement

of the Sherman Act." *Khan*, 522 U.S. at 18. *Dr. Miles* cannot plausibly be subjected to either criticism. It provides a clear rule addressing an abiding concern of antitrust law. See Certiorari-Stage Reply Brief for Petitioner at 7-8; AAI Br. § II(A).

5. That rule, it is important to emphasize, creates no doctrinal tension with the contemporary body of case law governing non-price vertical restraints – even assuming, contrary to much of the economic literature, see AAI Br. § II(C), that economic considerations do not justify treating vertical price and non-price restraints differently. We make this point because one of the Court's main concerns in addressing (non-price) agreements restricting vertical distribution has been to ensure that *GTE Sylvania*, which freed such agreements from per se condemnation, "is not frustrated by related legal rules." *Sharp*, 485 U.S. at 726. The ongoing application of the per se rule against vertical price-fixing in no way frustrates the types of non-price vertical distribution agreements that *GTE Sylvania* allows.

B. Overruling *Dr. Miles* Is Not Necessary to Allow Manufacturers to Address the Supposed "Free-Rider" Problem

1. None of the distributive efficiency rationales advanced by Petitioner in defense of vertical price-fixing – whatever their underlying merits – is so compelling as to justify overturning the long-standing per se rule governing vertical price-fixing. Even the economists who have joined Petitioner's cause as *amici curiae* do not consider abolition of the per se rule to be any sort of economic imperative. They themselves acknowledge the "disagreement" in the economic literature as to the "relative

frequency with which pro-competitive . . . effects" are likely to follow the institution of vertical price maintenance agreements. Brief of *Amici Curiae* Economists ("Econ. Br.") at 16. Cf. Robert H. Bork, *Memorandum to the Antitrust Modernization Commission* (2002), at 1, *available at* www.amc.gov/comments/bork (commenting that because the "antitrust laws are performing well, in fact better than at any time in the past seventy-five years, . . . there is very little need for 'modernization' "). All that these economists ultimately agree upon is that the economic literature does not support the proposition that vertical price-fixing is "most often" or "invariably" anticompetitive. *Id.* But again, contrary to the suggestion of Petitioner and the Solicitor General, the issue here is not whether the Court should extend per se treatment to vertical price-fixing but whether it should now withdraw it.

2. The main argument Petitioner advances in support of vertical price-fixing is that it allows a manufacturer "to ensure that dealers provide demand-creating services" by guaranteeing a sufficient profit margin. See Pet. Br. at 19. See also SG Br. at 10-12. "In the absence of resale price restraints," Petitioner claims, "free-rider problems may diminish retailers' incentives to provide these services." *Id.* at 19-20. See also SG Br. at 12-14.

Petitioner's argument begs the initial question whether, in practice, vertical price-fixing is even likely to induce a retailer to provide the sort of demand-creating services that a manufacturer may desire (even if the retailer is not competing with potential free-riders). Petitioner simply assumes, but does not demonstrate, that it likely will. This assumption rests on questionable grounds. See AAI Br. § II(B). Manufacturers that really want to

induce (rather than require) retailers to provide the sort of demand-creating retail "services" at issue in this case – *e.g.*, maintaining "attractive" merchandise displays, Pet. Br. at 3 – are likely to offer retailers lower prices (or other direct economic inducements) in exchange for a contractual commitment to provide the desired services. See AAI Br. § II(B)(3). (The practice is so common that it has long been regulated by federal law. See 15 U.S.C. § 13(d).)

In any event, Petitioner does not offer any empirical evidence that free-riding actually occurs with sufficient frequency to warrant Petitioner's concern. The economic literature is skeptical of claims of widespread free-riding. See, *e.g.*, Brief for William S. Comanor & Frederick M. Scherer at 6. Cf. SG Br. at 13 (emphasizing free-rider problem, but declining to take a position on whether free-riding is "extensive"). Many products are not even sold under conditions that allow for free-riding. See Phillip E. Areeda & Herbert Hovenkamp, 8 *Antitrust Law* ¶1601e, at 13 (2d ed. 2004). See also AAI Br. § II(B)(1).

As for manufacturers legitimately concerned about free-riding, this Court's decisions allow them to address the problem directly without running afoul of the antitrust laws – by contractually requiring that retailers provide whatever demand-creating services they wish, by offering direct economic incentives to provide the services (as discussed above), or by establishing market division arrangements of the sort that *GTE Sylvania* allows. *Dr. Miles* prohibits only price-fixing, and even then only when it takes the form of an actual agreement to fix prices: *United States v. Colgate & Co.*, 250 U.S. 300 (1919), which remains good law, allows a manufacturer to announce a "suggested manufacturer's retail price" and then terminate retailers that refuse to abide by it.

Petitioner acknowledges the various non-price-fixing options available to address the free-rider problem, but declares them less efficient than price-fixing. See Pet. Br. at 20. Here again even the economists supporting Petitioner are much less confident than Petitioner about the economic superiority of vertical price-fixing as a response to the free-rider problem. They note that only "in *some circumstances*" does retail price maintenance have the "*potential* . . . to ameliorate a free riding problem." Econ. Br. at 9 (emphasis added). Even when "alternative methods of curtailing free riding" may be less efficient, the economists supporting Petitioner concede, the efficiency gains of employing retail price maintenance "may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition." *Id.* See generally AAI Br. § II(B)(3).

CONCLUSION

For the foregoing reasons, the Court should decline to overrule *Dr. Miles* and affirm the judgment of the Court of Appeals.

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Dated: February 26, 2007

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR WILLIAM S. COMANOR AND FREDERIC M. SCHERER AS *AMICI CURIAE* SUPPORTING NEITHER PARTY

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STATEMENT OF INTEREST OF *AMICI CURIAE*[1]

Amici are two economists who have been writing and teaching in the field of industrial organization since the mid-1960s. Both served as Directors of the Bureau of Economics at the Federal Trade Commission and both are former presidents of the Industrial Organization Society. Both have written extensively about the economics of resale price maintenance (RPM) and vertical restraints more generally.

William S. Comanor is Professor of Economics at the University of California, Santa Barbara, and Professor of Health Services at the University of California, Los Angeles. He also served as Special Assistant to the U.S. Assistant Attorney General for Antitrust in 1967 and 1968. Frederic M. Scherer is Aetna Professor of Public Policy Emeritus at the John F. Kennedy School of Government, Harvard University. Neither *amicus* has had any employment or consulting relationship with the parties to this litigation, although work by *amicus* Scherer was cited in briefs to the Court by counsel for both petitioner Leegin and respondent PSKS.

Amici submit this brief in part to set the record straight on Scherer's views, but also to provide insights on the economic literature concerning resale price maintenance (RPM) and to suggest a tractable approach for implementing antitrust standards on RPM.

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[1] Counsel for both parties have consented to the filing of this brief, and their consents have been filed with the Clerk of this Court. No counsel for either party had any role in authoring this brief, and no person other than the named *amici* and their counsel has made any monetary contribution to the preparation and submission of this brief.

SUMMARY OF ARGUMENT

The assertion that output-expanding resale price maintenance enhances consumer welfare, often cited as a defense of RPM, should be recognized as a special case not applicable under plausible conditions. The free-rider justification for RPM is also not universally applicable and should be subjected to critical scrutiny, as the Federal Trade Commission did in *In the Matter of Toys "R" Us*, 126 F.T.C. 415, 567-607 (1998). To the extent that the economic literature provides support for resale price maintenance as welfare-enhancing, the support is limited to cases of manufacturer-induced RPM, not retailer-induced RPM. The distinction should be recognized in adjudicating RPM complaints. Retailer-induced RPM should give rise to a rebuttable *per se* approach, whereas manufacturer-induced RPM should be subjected to a rule of reason when it is widespread within a product line or effected in concentrated oligopolistic markets.

ARGUMENT

A. The Conflicting Citations

In its *certiorari* brief filed before the Court on November 6, 2006 at page 16, respondent PSKS cites work by *amicus* Scherer to support the position that "the elimination of resale price maintenance has led to significant savings for consumers." In its reply brief filed on November 20, 2006 at pages 6-7, petitioner Leegin quotes a statement by *amicus* Scherer from the cited work that "[m]y own view has long been that vertical restraints are benign or efficiency enhancing more often than not, leading me to recommend that a rule of reason be applied." It goes on to observe that *amicus* Scherer

was among the 25 economists submitting an *amicus curiae* brief urging that the *per se* rule against resale price maintenance be overturned.

There is no necessary conflict here. It is entirely possible for resale price maintenance arrangements to be efficiency enhancing in some circumstances but injurious to consumer welfare in others. And given this diversity of effects, one could reasonably take the position that a *rule of reason* rather than a *per se* approach is warranted. What does need clarification, however, is that *amicus* Scherer agreed to sign the 25 economists' brief only on the condition that the cited article by Scherer summarizing research on the consumer harm from RPM, along with one by *amicus* Comanor, be referenced in the section acknowledging that there is "disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has pro-competitive or anticompetitive effects." [Section I.C.4 of the 25 economists' brief.]

The 25 economists' *certiorari* brief urges that the long-standing *per se* rule against resale price maintenance be replaced by a *rule of reason*, but offers no suggestion how the rule of reason would be implemented. If the Court accepts that plea, it is essential that the Court articulate guidelines for implementation by the lower courts. A primary purpose of this brief is to suggest such guidelines. *Amici* believe strongly that a rule allowing all RPM, good and bad, to proliferate would impose significant burdens on the U.S. economy. That lesson was clearly recognized when Congress repealed the Miller-Tydings Act in 1975. It should not be forgotten.

B. Theoretical Foundations

Before making policy suggestions, we need to clarify certain points that are both theoretical and empirical. It is uniformly acknowledged that RPM and other vertical restraints lead to higher consumer prices.[2] And studies have suggested that these higher prices can be substantial.[3] According to an argument originally advanced by Robert Bork, however, the higher RPM-induced retailer margins lead to increased pre-sale services by retailers, which in turn causes output to expand. As a result, the higher margins promote enhanced consumer welfare and efficiency.[4]

Although Bork's point is sometimes correct, it is not always so. *Amici* Comanor and Scherer have both shown that consumer welfare can decline even though output is increased.[5] The net welfare consequence depends critically

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[2] As long ago as 1984, Judge Frank Easterbrook wrote: "Every argument about restricted dealing implies that the restrictions influence price. There is no such thing as a free lunch; the manufacturer can't get the dealer to do more without increasing the dealer's margin." Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 156 (1984).

[3] F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance*, 3rd ed. (1990) at pp. 555-556.

[4] Robert H. Bork, *The Antitrust Paradox* (1978), p. 290; and *Resale Price Maintenance and Consumer Welfare*, 77 Yale L.J. 950 (1968).

[5] The most transparent synthesis of two earlier proofs is found in Scherer and Ross, *supra* note 2 at pp. 541-548. It extends and simplifies F.M. Scherer, *The Economics of Vertical Restraints*, 52 Antitrust L.J. 687 (1983); and William S. Comanor, *Vertical Price Fixing and Market Restrictions and the New Antitrust Policy*, 98 Harv. L. Rev. 990 (1985).

upon the nature of the demand shift induced by the provision of pre-sale services as well as the magnitude of the shift (*i.e.*, the elasticity of demand with respect to the volume of pre-sale services).

The intuition for this result follows from the likelihood that consumers who derive substantial consumer surplus from a product are likely to be informed of the product's merits without any special help from retailers. These infra-marginal consumers are harmed by the higher prices resulting from RPM. On the other hand, it is the less informed, marginal consumers who derive most of the benefits from the services and whose purchases increase. This is a plausible situation, as it is recognized that the consumers most likely to be influenced by additional pre-sale services are those "who are indifferent between purchasing or not."[6] Furthermore, to the best of *amici*'s knowledge, no one has rebutted their proof that the Bork result is a special case not applicable under many circumstances. The Bork argument should not be accepted by the Court as a general principle.

A second point concerns the most popular defense for supplier-mandated RPM, which is the so-called free-rider argument.[7] It asserts that unless all distributors are required to charge the same high price, a high-price retailer may provide pre-sale services, after which a customer who has received those services without charge will purchase the item from a "free-riding" distributor who provides no such

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[6] James Cooper, Luke Froeb, Daniel O'Brien, and Michael Vita, *Vertical Restrictions and Antitrust Policy: What About the Evidence?* 1 Competition Pol'y Int'l 45, 49, 51 (2005).

[7] This argument was made originally by Lester Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960).

services but sets a lower price. RPM is needed to prevent free-riding and ensure that desired services are supplied.

Although this result is possible, there is skepticism in the economic literature about how often it actually occurs.[8] In the most thoroughly litigated antitrust case known to *amici*, Toys "R" Us argued that a different type of vertical restraint — a boycott of warehouse clubs TRU coerced from toy manufacturers — was justified because the warehouse clubs free-rode on TRU's inventory stocking and advertising activities. The Federal Trade Commission found TRU's free-rider defense to be without merit,[9] and on appeal, the Seventh Circuit agreed:[10]

> Here, the evidence shows that the free-riding story is inverted. The manufacturers wanted a business strategy under which they distributed their toys to as many different kinds of outlets as would accept them: exclusive toy shops, TRU, discount department stores, and warehouse clubs. . . . What TRU wanted or did not want is neither here nor there for purposes of the free rider argument. . . .

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[8] The literature is reviewed in Scherer and Ross, *supra* n. 4, at pp. 551-555. *See also* William S. Comanor, *The Two Economics of Vertical Restraints*, 5 Rev. Indus. Org. (Summer 1990), and William S. Comanor, F.M. Scherer and Robert L. Steiner, *Vertical Antitrust Policy: Getting the Balance Right*, American Antitrust Institute, September 6, 2005.

[9] *In the Matter of Toys "R" Us*, 126 F.T.C. at 567-607. *Amicus* Scherer was the economic witness for the FTC staff.

[10] *Toys "R" Us v. Federal Trade Commission*, 221 F.3d 928, 938 (2000).

> Furthermore, we note that the Commission made a plausible argument for the proposition that there was little or no opportunity to "free" ride on anything here in any event. The consumer is not taking a free ride if the cost of the service can be captured in the price of the item. . . . [T]he manufacturers were paying for the services TRU furnished, such as advertising, full-line product stocking, and extensive inventories.

What this example shows is that arguments supporting RPM and other vertical restraints on free-riding grounds should not be accepted without the most careful analytic and factual scrutiny.

C. The Two Economics of RPM and Other Vertical Restraints

More than fifteen year ago, *amicus* Comanor observed that there are two separate bodies of economic literature dealing with vertical restraints, with distinct welfare and policy implications.[11] Both are relevant for determining appropriate antitrust standards.

In the first, restraints are imposed unilaterally by the seller, normally a manufacturer, to achieve increased sales; while in the second, they are instigated by buyers, normally distributors of the manufacturer's products, in order to protect their high prices. Strikingly, **the efficiency defenses of RPM and other similar restraints arise preponderantly from circumstances where the manufacturer is the moving**

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[11] Comanor, *The Two Economics of Vertical Restraints*, *supra*, n. 6.

party. To the knowledge of the *amici*, there are no arguments in economic analysis supporting restraints arising from distributor actions or pressures. In such circumstances, RPM and similar restraints lead to higher consumer prices with nc demonstrated redeeming values, unless one subscribes to the notion that protecting small retailers is desirable in its own right.

In the past, retailers initiated RPM by threatening to boycott manufacturers' goods unless RPM is imposed, or by bringing other kinds of pressures to bear on local and state governments. An important historical example is that of the retail pharmacists. Their trade association lobbied extensively for state RPM laws and offered draft statutes that were often enacted with little or no amendment by state legislatures.[12] Retail pharmacies were among the last bastions of widespread "fair trading" when the Miller-Tydings Act was repealed in 1975. From the late 1960s to 2003, retail pharmacy margins fell from an average of 40 percent to approximately 20 percent — a saving to consumers and health care insurers of some $40 billion at 2003 sales volumes.[13]

D. Designing Appropriate Standards

The source of the restraint is thus a significant consideration in determining appropriate antitrust standards. For this reason, a "quick look" approach is appropriate.

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[12] F.M. Scherer, *How U.S. Antitrust Can Go Astray: The Brand Name Prescription Drug Litigation*, 4 Int'l J. Econ. Bus. 239, 244-6 (1997).

[13] F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Comp. Pol'y Int'l 65-74 (2005).

Evidence from a quick look that the restraint was induced by distributors should lead to the presumption of a *per se* violation, rebuttable on the presentation of credible contradictory evidence. On the other hand, preliminary evidence that the restraint was instigated by the manufacturer should trigger a *rule of reason* adjudication.

Where a *rule of reason* approach is appropriate, a test of quantitative substantiality should be applied. The reason is that RPM is most likely to be harmful to consumers when widely applied in a meaningful product line. In such circumstances, consumer choice is restricted to goods bearing high distribution margins in the absence of possible lengthy and energy-guzzling shopping trips. And if under the umbrella of high margins, most retailers engage in substantial pre-sale promotion, their efforts will largely cancel each other out in the aggregate, leading to a high-price, high-margin, high promotional cost equilibrium with relatively little if any expansion of demand.

A rule that takes these considerations into account and strikes a desirable balance between judicial economy and maintaining competition would entail a rebuttable presumption of illegality when the volume of fair-traded sales in a relevant narrowly-defined line of commerce exceeds, say, 50 percent. If this structural criterion is satisfied, antitrust standing would be granted if RPM is *extended* to cover an additional 10 percent of the relevant sales — an increment consistent with the 100 point Herfindahl-Hirschman index change under which anti-merger actions are triggered under the joint Department of Justice - Federal Trade Commission Merger Guidelines.

This structural test would be only the first stage in a RPM *rule of reason* proceeding. Respondents could then rebut the presumption of illegality by proving that the relevant market is improperly defined, that consumers' choices have not in fact been significantly limited, and/or that the restraints were necessary to sustain the provision of services valuable to consumers.

Alternatively, the triggering rule could conform even more closely to the approach taken in the Merger Guidelines. The first structural test would inquire whether the relevant line of commerce is oligopolistic, *e.g.*, with a Herfindahl-Hirschman index exceeding 1800. Focusing on oligopolistic sellers' market structure is appropriate because under oligopoly, imitation of one leading seller's marketing strategy by other sellers is more likely than with atomistic market structures. Antitrust action could then be triggered when RPM is implemented by a seller with a relevant market share of 10 percent or more, *i.e.*, with a Herfindahl-Hirschman change of 100 or more. Again, the presumption of illegality could be rebutted under a *rule of reason* defense.

CONCLUSION

The issue before the Court is an important one for American consumers. The wrong set of rules could encourage proliferation of RPM contracts, impose substantial losses on consumers, and impair the impressive efficiency of the distribution sector in the United States. Marketing innovation should not be discouraged by the imposition of RPM-type restraints. *Amici* believe that some approximation to the approach suggested here would achieve an appropriate tradeoff between consumer benefit, limited government intervention in the marketplace, and adjudicative feasibility.

Respectfully submitted,

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No. 06-480

In The

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC. D/B/A KAY'S KLOSET . . . KAY'S SHOES,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF OF *AMICUS CURIAE* CONSUMER FEDERATION OF AMERICA IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE*[1]

The Consumer Federation of America ("CFA") is the nation's largest consumer advocacy group, composed of two hundred and eighty state and local affiliates, representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, with more than fifty million individual members. The CFA appears regularly before legislative, judicial, and administrative bodies at the federal, state, and municipal levels. In particular, the CFA provided testimony to Congress during the hearings that preceded the passage of the Consumer Goods Pricing Act of 1975, a law that is at the heart of this case.

The CFA's members include consumers interested in promoting vigorous competition at all levels of production and distribution in the nation's economy. Robust competition at the retail level benefits American consumers by yielding lower prices, more choice, better service, and increased innovation. The CFA has a strong interest in the proper application and the vigilant enforcement of the antitrust laws, including the *per se* rule against minimum resale price maintenance, which, when properly applied and enforced, serves to ensure the benefits of such competition to American consumers.

SUMMARY OF ARGUMENT

For nearly a century, under Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1, it has been a *per se* illegal "restraint of trade" for manufacturers and retailers to agree to fix a minimum retail price. During that time, the

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[1] All parties have consented to the filing of this brief. The parties' letters of consent have been lodged with the Clerk. Under S. Ct. Rule 37.6, *amicus curiae* states that no counsel for a party has written this brief in whole or in part and that no person or entity, other than the *amicus curiae*, its members, or its counsel, has made monetary contributions to the preparation or submission of this brief.

per se rule against resale price maintenance ("RPM") has safeguarded low consumer prices and an abundance of consumer choice, witnessing an unparalleled period of dynamic innovation in retailing by fostering competition at the retail and manufacturing levels. By preventing RPM, which is designed to discourage price cutting, the *per se* rule has set the stage for innovative retailers to continually enter the market, offering new and lower priced alternatives to consumers. By encouraging such entry, the *per se* rule has enhanced "intertype competition," that is, competition among different kinds of retailers, such as boutiques, department stores, superstores, and online sellers—providing substantial benefits to consumers.

Accumulated experience has shown that RPM invariably raises consumer prices. Both empirical evidence and economic theory confirm that this is so. By facilitating cartelization and by giving rise to unilateral incentives for dealers and manufacturers to keep prices artificially high, RPM raises consumer prices, even in the absence of manufacturer market power. After a limited but failed experiment with "fair trade," which legalized RPM under color of state law for a period of time, Congress passed the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, which amended the Sherman Act to restore and to preserve the *per se* rule as part of an historic effort to combat inflation.

The plain language and the import of the Consumer Goods Pricing Act have been recognized by this Court on more than one occasion. By its express terms, the amendment provides that it was adopted "to provide lower prices for consumers," and, therefore, precludes the application of a rule of reason to RPM, as it is undeniable that RPM actually imposes higher prices on consumers.

The proposed theoretical justifications in defense of RPM, while appropriate for other types of vertical restraints, are quite limited in their application and are belied by the real-world historical and empirical evidence

demonstrating the anticompetitive effects of RPM and the benefits of the *per se* rule. Such theoretical justifications can in no way offset the higher consumer prices, lower consumer choice, and stifled innovation that history teaches will follow the elimination of the *per se* rule. A rule of reason designed to entertain such justifications thus would provide cold comfort to American consumers; for it is widely recognized that to accord RPM a rule of reason treatment would effectively make RPM *per se* legal.

There is no good reason to abandon the venerable *Dr. Miles* rule. This is especially true given the common law nature of antitrust, in light of America's experience with the anticompetitive effects of RPM and the dynamic benefits of the *per se* rule; the expressed endorsement of the rule by Congress; and the widespread reliance on the rule by American consumers for decades. The Court should reaffirm that minimum resale price maintenance is *per se* illegal and affirm the judgment of the court of appeals.

ARGUMENT

MINIMUM RESALE PRICE MAINTENANCE SHOULD REMAIN *PER SE* ILLEGAL

I. ELIMINATION OF THE *PER SE* RULE WILL SIGNIFICANTLY IMPEDE THE ECONOMIC DYNAMISM IN DISTRIBUTION ENJOYED BY CONSUMERS SINCE THE *DR. MILES* CASE WAS DECIDED

"The American system for distributing goods and services is a wonder to behold for its variety and its remarkable efficiency." HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE 181 (2005). It is such a "wonder" due in great measure to the many innovations in retailing that have occurred since the Court decided *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911).

Innovations in retailing are fostered by an environment conducive to *intertype* competition—the competition

between different *kinds* of retailers. *See* JOSEPH CORNWALL PALAMOUNTAIN, JR., THE POLITICS OF DISTRIBUTION 38 (1955).[2] Experience teaches that new types of retailers enter the market as low-cost alternatives to traditional retailers, passing their inherent cost-savings on to consumers by cutting prices and often offering more convenient service. With RPM in place, the opportunities and incentives for such potential entrants to provide innovative low-cost retail solutions to consumers are diminished, if not eliminated. By stifling price competition and consumer choice, RPM creates barriers to entry for new types of firms and denies consumers the benefits of the efficiencies that such potential new entrants might pass on, as well as the disciplining effect that such competition has on both the retail and manufacturing sectors. The *per se* rule has served consumers well by acting as a force to prevent the formation of such barriers to entry and, as a result, has witnessed successive revolutions in retailing that have directly and significantly contributed to consumer welfare.

Competition between different types of retailers "is a vital part of a free market system for distribution of goods and services." LAWRENCE A. SULLIVAN & WARREN S. GRIMES, THE LAW OF ANTITRUST, § 6.1, at 323 (2d ed. 2006). Indeed, the "gale of creative destruction" that brings competition from "the new type organization . . . which commands a decisive cost or quality advantage" is not confined to the manufacturing sector; for in the "retail trade, the competition that matters arises not from additional

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[2] *See also* PATRICK DUNNE & ROBERT F. LUSCH, RETAILING 117 (3d ed. 1999); Robert L. Steiner, *How Manufacturers Deal with the Price Cutting Retailer: When are Vertical Restraints Efficient?*, 65 ANTITRUST L.J. 407, 419-26 (1997); Harry S. Gerla, *Restoring Rivalry as a Central Concept in Antitrust Law*, 75 NEB. L. REV. 209, 245 (1996); Robert L. Steiner, *The Nature of Vertical Restraints*, 30 ANTITRUST BULL. 143, 152-56 (1985); Richard M. Steuer, *Exclusive Dealing in Distribution*, 69 CORNELL L. REV. 101, 123-24 (1983).

shops of the same type, but from the department store, the chain store, the mail order house and the supermarket. . . ." JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 84-85 (3d ed. 1950).

The phenomenon of evolutionary innovation in distribution is widely recognized and studied in the field of marketing as the "wheel-of-retailing," a theory that explains the rise and fall of various modes of retail distribution. *See* PHILIP KOTLER & GARY ARMSTRONG, PRINCIPLES OF MARKETING 448 (10th ed. 2004). History shows that new and more efficient types of retailers first enter the market as low-cost dealers to compete with incumbents, only to be then subsequently challenged by yet another generation of new and more efficient retailers of still a different type. This cycle repeats itself again and again over time, always bringing increasingly efficient modes of retailing to the consuming public. Because entry is contingent on the ability of new firms to enter the market by offering lower prices, RPM, by stabilizing price levels and preventing low-price competition, erects a potentially insurmountable barrier to entry for such low-price innovators, who represent "the very heart of a free market competitive system." Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a Per Se Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1493 (1983).

Petitioner and its *amici* do not acknowledge "the dynamic effects that spring from the rule against resale price maintenance." Eleanor M. Fox, *Consumer Beware Chicago*, 84 MICH. L. REV. 1714, 1717 n.14 (1986). In assuming that the retail sector is a mere conduit exhibiting atomistic competition, they overlook the robust contribution that intertype competition has played in the development of the American economy. Instead, they focus on a short-term efficiency analysis predicted by a static microeconomic model that does not account for the significant benefits that intertype competition brings to consumers and the economy over the long run. Thus, they fail to recognize that with supermarkets as much as with semiconductors, "competition's role in spurring

innovation—that is, in maintaining dynamic efficiency—has secured a central position in antitrust analysis, leading us to take a broader focus that incorporates issues of innovation and progress over time." Hon. Deborah Platt Majoras, Chairman, Federal Trade Commission, *The Federal Trade Commission in the Online World: Promoting Competition and Protecting Consumers*, Address to the Progress & Freedom Foundation's Aspen Summit, at 19 (Aug. 21, 2006), *available at* http://www.ftc.gov/speeches/majoras.htm.

Currently, consumers have the choice of buying the very same product accompanied by varying degrees of customer service at a variety of price levels from a variety of different kinds of dealers. Where the choice of price and quality is left to the consumer, intertype competition is preserved because the "free market will decide the mix of price, quality, and related attributes that consumers value most." Robert H. Lande, *Consumer Choice as the Ultimate Goal of Antitrust*, 62 U. PITT. L. REV. 503, 503 n.3 (2001). By "impeding the 'ordinary give and take of the market place,'" *FTC v. Indiana Fed'n of Dentists*, 476 U.S. 447, 459 (1986) (quoting *National Soc'y of Prof'l Eng'rs v. United States*, 435 U.S. 679, 692 (1978)), RPM denies consumers the opportunity to choose the optimal mix, and so new retailers have little opportunity or incentive to create more efficient methods of distribution to serve consumers, because such potential entrants could never pass on any of their inherent cost-savings to customers on price-maintained branded products. However, "[w]hen they are allowed to compete freely, resellers are likely to develop innovative means of delivering services consumers desire." Thomas A. Piraino, Jr., *A Proposed Antitrust Approach to the Conduct of Retailers, Dealers, and Other Resellers*, 73 WASH. L. REV. L.J. 799, 855 (1998).

As it is axiomatic that "immunity from competition is a narcotic, and rivalry is a stimulant, to industrial progress [and] that the spur of constant stress is necessary to counteract an inevitable disposition to let well enough

alone," *United States v. Aluminum Co. of America*, 148 F.2d 416, 427 (2d Cir. 1945), it is unsurprising that historically the chief proponents of RPM have been associations of established retailers. Indeed, a primary argument in favor of RPM was to protect existing retailers from new and "more efficient dealers." VIII PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW, ¶ 1629b, at 298 (2d ed. 2004).[3] While established dealers and their captive manufacturers might enjoy maintaining the *status quo* through the use of RPM, it is at the expense of consumers, who are denied the benefits of the innovations in distribution made possible by robust intertype competition.

Although during the "fair trade" era, the proponents of RPM were partially successful in securing the legality of RPM for some products in some states for a period of time, the *per se* rule has endured and promoted intertype competition to the great benefit of American consumers, having let thrive a wondrous variety of retail options, such as department stores, mail-order businesses, supermarkets, superstores, and online retailers. *See* Fox, *supra*, at 1717 n.14. Had antitrust law been lenient on RPM on a nationwide basis for all of this time, it is unlikely that society would have benefited as it has from these "pioneering developments that have changed our lives and lifestyles." PHILIP KOTLER,

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[3] *See also* F.M. SCHERER & DAVID ROSS, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 548-49 (3d ed. 1990); I THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES 462 (Earl W. Kintner, ed. 1978); DANIEL J. BOORSTIN, THE AMERICANS: THE DEMOCRATIC EXPERIENCE 111 (1973); REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 153 (1955); PALAMOUNTAIN, *supra*, at 42; Richard C. Schragger, *The Anti-Chain Store Movement, Localist Ideology, and the Remnants of the Progressive Constitution, 1920-1940*, 90 IOWA L. REV. 1011, 1013 (2005); Reinhold Wolff & Duncan Holthausen, *The Control of Retail Prices Under the Fair Trade Laws*, DUN'S REVIEW, at 15 (July 1938); *Speeches Regarding Resale Price Maintenance*, NATION'S BUSINESS, at 33 (Feb. 16, 1914).

ACCORDING TO KOTLER: THE WORLD'S FOREMOST AUTHORITY ON MARKETING ANSWERS YOUR QUESTIONS 58 (2005).

Absent the *per se* ban on RPM, would there ever have been a Sears & Roebuck, an A&P, a Walgreens, a K-Mart, or a Wal-Mart, as we have come to know them? The evidence suggests not. Twenty-five years ago, when the specter of widespread RPM loomed prior to the *Monsanto* case, several leading executives in the discount retailing business, including a Wal-Mart executive, were interviewed regarding the effect that RPM might have on their businesses. *See Forward: Antitrust and the Discounters' Case Against Resale Price Maintenance*, 14 ANTITRUST L. & ECON. REV. 1 (1982). At that time, Wal-Mart was a decidedly regional player with 520 stores in 14 states, with annual sales of $3.6 billion. *See* S. Robson Walton, *Antitrust, RPM, and the Big Brands: Discounting in Small Town America*, 14 ANTITRUST L. & ECON. REV. 81, 81 (1982). S. Robson Walton, like so many of his contemporaries, predicted that relaxing the *per se* ban on RPM would be a "great danger" to Wal-Mart's business. *Id.* at 83.

Not long after that interview, the Court refused to heed the call of the Antitrust Division to overrule *Dr. Miles*. Since then, the *per se* rule has remained firmly in place, ensuring the development of a "quintessential American success story." RICHARD VEDDER & WENDELL COX, THE WAL-MART REVOLUTION: HOW BIG-BOX STORES BENEFIT CONSUMERS, WORKERS, AND THE ECONOMY 179 (American Enterprise Institute 2006); *see also* S. Robson Walton, *Wal-Mart, Supplier-Partners, and the Buyer Power Issue*, 72 ANTITRUST L.J. 509, 510-11 (2005). By 2005, Wal-Mart's sales had grown nearly one-hundred-fold, to $312.4 billion, with the company serving 138 million customers per week in 6,200 stores spanning the globe, with 3,800 stores located all across the United States. *See The Wal-Mart Timeline*, *at* http://www.walmartfacts.com/content/default.aspx?id=3.

This story is more than a testament to the retail business opportunities created by the *per se* rule against RPM, however; for Wal-Mart's success has directly contributed to consumer welfare. Having "mastered the ability to obtain products cheaply," Schragger, *supra*, at 1088, Wal-Mart has passed on its cost-savings to consumers and is credited by economists with having single-handedly held down inflation for the entire country. *See* Steven Greenhouse, *Wal-Mart, a Nation Unto Itself*, N.Y. TIMES, Apr. 17, 2004, at 7. By increasing consumer surplus and thus real income, Wal-Mart has "enriched millions of consumers, many of them persons of modest means." VEDDER & COX, *supra*, at 179. Had the Court taken up the Antitrust Division on its invitation to overrule *Dr. Miles* in the *Monsanto* case, would this have been possible? Further to the point, absent the commercial incentives available to the pioneers of online retailing to sell brand-name products at prices reflecting the efficiency of new business models, would Internet commerce have developed as it has? Would there ever have been an Amazon.com?

The wheel-of-retailing is no "free ride." Rather, it is creative destruction at work. Vigorous intertype competition has been a hallmark of our progression from the Industrial Revolution that heralded the Sherman Act to today's Information Age. Yesterday's "knave," to quote Justice Holmes from his *Dr. Miles* dissent, is today's Sam Walton or Jeff Bezos. By impeding dynamic new entrants' ability to pass along efficiency gains to customers, RPM stifles important free market forces to the detriment of American consumers. To overrule *Dr. Miles* would serve to entrench current modes of retailing and delay—or perhaps even prevent—The Next Big Thing. Since "the worst mistake we can make is to assume that we know it all," Majoras, *supra*, at 11, perhaps the most important reason to uphold

the *Dr. Miles* rule is explained by the old adage: "If it's not broken, don't fix it."[4]

II. ACCUMULATED EXPERIENCE SHOWS THAT RPM VIRTUALLY ALWAYS LEADS TO HIGHER CONSUMER PRICES

Experience has shown that RPM agreements virtually always raise consumer prices. Both empirical evidence and economic theory confirm this undeniable fact. RPM has been shown to dramatically increase prices not only on price-maintained products, but also on other competitive products by facilitating cartelization and by giving rise to unilateral incentives for dealers and manufacturers to raise prices, even in the absence of manufacturer market power.

RPM prevents price cutting—the very "essence of competition." *State Oil Co. v. Kahn*, 522 U.S. 3, 15 (1997). "Price," this Court has held time-and-again, is the "central nervous system of the economy." *Prof'l Eng'rs*, 435 U.S. at 696. Absent predation, "low prices benefit consumers regardless of how those prices are set, and ... do not threaten competition," *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, No. 05-381, slip op. at 6 (U.S. Feb. 20, 2007) (quoting *ARCO v. United States Petroleum Co.*, 495 U.S. 328, 340 (1990)), as "[i]t is in the sound commercial interests of the retail purchasers of goods and services to obtain the lowest price possible." *Reiter v. Sonotone Corp.*,

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[4] *Oversight Hearings on Authorization of the Antitrust Division of the Department of Justice Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary*, 99th Cong., at 17 (1985) (statement of Prof. Lawrence S. Sullivan); *cf. Public Comments Received by the Antitrust Modernization Comm'n* (2004) (memorandum of Robert H. Bork), *available at* http://www.amc.gov/comments/bork.pdf ("The antitrust laws, in my opinion, are performing well, in fact better than at any time in the past seventy-five years. It follows that I think there is very little need for 'modernization.'").

442 U.S. 330, 342 (1979). *See also Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.) (antitrust policy "discouraging legitimate price competition" should be avoided). Retail price competition is so important to our free market system that the right of retailers to communicate prices to consumers is protected by the First Amendment. *See 44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 515 (1996).

A. Empirical Evidence Shows That RPM Dramatically Raises Consumer Prices

America's experience with the inflationary price effects of RPM is ignored at the peril of the American consumer. Study after study has confirmed that consumer prices are far higher when RPM is allowed.[5] American consumers experienced firsthand the anticompetitive and inflationary effects of RPM during the "fair trade" era. Fair trade was abandoned and the *per se* rule against RPM was reinstated in 1975 to combat inflation. The repeal of fair trade was no whim. Rather, it was a deliberate response to a failed experiment. A wealth of evidence before Congress showed that consumer prices were far higher where RPM was not prohibited. For instance, many of the same consumer goods sold at prices on average as much as 27 percent higher in fair trade states than in non-fair trade states. *See* KINTNER, *supra*, at 958. Additionally, prices for certain products declined much as 40 percent in states where fair trade laws were repealed by state law prior to federal repeal. *Id.* at 978. Overall, numerous studies estimated that RPM cost American consumers anywhere from $3 billion up to $6.5 billion annually—in 1975 dollars. *Id.* at 958.

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[5] *See* AREEDA, *supra*, ¶ 1604b, at 40; SCHERER & ROSS, *supra*, at 555; Ittai Paldor, *Rethinking RPM: Did the Courts Have it Right All Along?* at 63-68 (S.J.D. Thesis, University of Toronto 2007), *available at* http://www.papers.ssrn.com/sol3/papers.cfm?abstract_id=959336.

Today, the cost to consumers of treating RPM leniently on a nationwide basis would be staggering. An illustrative 1982 study estimated that reinstituting RPM nationally would raise prices on about one-third of consumer products by as much as 20 percent, costing consumers up to $18 billion annually. *See Antitrust and the Discounters' Case Against Resale Price Maintenance*, *supra*, at 3-4. If those estimates hold true 25 years later, the cost to American consumers will reach and exceed $40 billion annually. *Accord* VEDDER & COX, *supra*, at 17 (estimating aggregate consumer surplus resulting from big-box discounting segment to be $40 billion).

B. RPM Raises Consumer Prices by Facilitating Cartels

The Court has observed that collusion, the "supreme evil of antitrust," *Verizon Commc'ns, Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 407 (2004), is facilitated by resale price maintenance. *See, e.g., Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 51 n.18 (1977).[6] Indeed, "collusive pressure by dealers may best explain" the existence of RPM on products sold in multi-brand outlets where dealer services or other such considerations could not possibly have been important to manufacturers, including arrangements involving:

> gasoline, auto parts, toiletries, paper, beer, men's shoes, rainwear, women's and children's clothing, underwear, cosmetics, perfumes, over the counter drugs, tobacco products and accessories, simple photographic supplies, drug store watches and clocks, eyeglass lenses, and small appliances.

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[6] *See also* AREEDA, *supra*, ¶ 1604a, at 36; SULLIVAN & GRIMES, *supra*, § 6.1a, at 321-22; Pitofsky, *In Defense of Discounters*, *supra*, at 1490-91; *cf.* AREEDA, *supra*, ¶ 1604c, at 46 & n.45 (observing infirmities of surveys of reported cases that might be taken to suggest otherwise).

AREEDA, § 1604b, at 39; *see also* HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY, § 11.2b, at 396-97 (1994). Thus, "experience shows that the manufacturer is often induced to act as an organizer of the dealer's cartel by dealer threats or enticements." Pitofsky, *In Defense of Discounters*, *supra*, at 1490.

There are "good reasons" why retailers would want to involve suppliers in a dealer cartel. HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra*, § 11.2b, at 395. A "dealer cartel with manufacturer-supplier participation is likely to produce a more stable and durable dealer cartel than a purely horizontal arrangement." Pitofsky, *In Defense of Discounters*, *supra*, at 1490. The cartel will be strengthened because manufacturer participation can dramatically cut down on "cheating":

> [I]f the majority can convince the manufacturer-supplier to participate (and if vertical price fixing were in some circumstances legal, or difficult to prove illegal because of rule of reason treatment), the manufacturer-supplier will be able to cut off the dissenters' access to the product. Participation by the manufacturer-supplier thereby stabilizes the cartel. The arrangement will be particularly effective if, as is usually the case, the dealers agree to police violations.

Id.; *see also* AREEDA, *supra*, ¶ 1604c, at 45. While such conspiracies have proven particularly prevalent at the retail level, RPM also has the propensity to facilitate collusion at the manufacturer level by deterring cheating and facilitating information exchange, especially in concentrated markets. *Id.*, ¶ 1606a, at 81. This effect is an "additional anticompetitive factor to add to the rigidifying price effect that almost always occurs at the dealer level." Pitofsky, *In Defense of Discounters*, *supra*, at 1490.

C. RPM Raises Consumer Prices Even in the Absence of Cartelization

A formal dealer cartel is not necessary for a manufacturer to adopt RPM in its unilateral self-interest in response to dealer power and other forces at odds with the interests of consumers. The view that RPM is often benign, however, is based upon the premise that the manufacturers' interest is always aligned with that of the end consumer—a "short-run and rather impractical view of the distribution process." Pitofsky, *In Defense of Discounters*, *supra*, at 1491. For instance, a "manufacturer might be forced to restrain distribution in order to appease one or more individually powerful dealers." AREEDA, *supra*, ¶ 1604d, at 47. Given the current state of the retail industry, which has grown ever so concentrated,[7] this threat is of acute concern.

Manufacturers likewise have an interest in maintaining high retail prices in order to avoid wholesale price erosion—an interest also not shared by consumers. "[O]ver the long haul, it is likely that the profits from a high retail price will be shared by both the manufacturer and the dealer: the manufacturer in a higher wholesale price and the dealer in a higher retail price." Pitofsky, *In Defense of Discounters*, *supra*, at 1493; *see also* AREEDA, *supra*, ¶ 1606c, at 85-86. Vigorous retail price competition eats away at the profits of retailers such that retailers will eventually pressure the manufacturer to drop its wholesale price. The reduction in wholesale price will lead the manufacturer's competitors to do so too, thus allowing for consumer prices to fall not only within a brand but among competing brands. RPM is a device to thwart such price erosion by preventing retailers from cutting prices, but it

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[7] *See, e.g.*, U.S. Dep't of Justice, Antitrust Division, *Statement on the Closing of its Investigation of Whirlpool's Acquisition of Maytag* (Mar. 29, 2006), *available at* http://www.usdoj.gov/atr/public/press_releases/2006/215326.htm.

is at the expense of interbrand competition and consumer welfare.

A rational manufacturer with less relative power than its retailers might also unilaterally adopt RPM as a logical way of favoring a majority of its established outlets that might like to be protected from competition from upstart discounters. *See* AREEDA, *supra*, ¶ 1604a, at 36; Steiner, *How Manufacturers Deal with the Price Cutting Retailer, supra*, at 419-26. Any of the manufacturer's competitors without market power would then follow suit or risk having their product dropped by those dealers. This opportunity would allow producers with powerful brands—whose products could not be profitably dropped by a multibrand dealer—to raise their prices, as their inherent product differentiation allows them to price their brands above the rest. *See, e.g.*, SULLIVAN & GRIMES, *supra*, § 6.2b, at 331; *id.*, § 6.3c, at 345. As there are relatively few products with substantial brand equity for any particular relevant product, oligopolistic forces will likely raise the price level of those products, and prices of brands with less power and house-branded products will follow suit. As a result of such emulation, in the aggregate, consumer prices will rise dramatically—even absent collusion.

III. RPM CANNOT BE JUSTIFIED AS REASONABLE BY THE PROCOMPETITIVE POTENTIAL OF OTHER DISTRIBUTION STRATEGIES

This case is not *Sylvania*, nor is it *Khan*. Unlike other cases in which this Court has abandoned the *per se* rule in favor of a rule of reason analysis, experience reveals the anticompetitive effects of RPM on innovation and on price to be far too severe to allow justification. RPM should not be evaluated under the rule of reason, despite any linguistic appeal that such a characterization might tempt. The fundamental differences between RPM and other vertical

restraints, as well as the limits of the asserted procompetitive justifications for RPM, reveal that the *per se* rule should remain in place.

A. RPM and Other Vertical Restraints Materially Differ

RPM has far different effects in kind and in scope than do other vertical restraints. To begin with, while maximum vertical price fixing leads to lower prices, RPM invariably leads to higher prices. Although setting a price ceiling often serves to benefit consumers by lowering prices, setting a price floor through RPM will always have the opposite effect. *See Khan*, 522 U.S. at 15. It therefore makes perfect sense to evaluate maximum vertical price fixing under the rule of reason while at the same time standing firm against RPM with "a *per se* rule affecting the conduct of the entire marketplace." *Id.* at 19. As the practices have opposite effects, adopting opposing standards for each will serve the very same goal: to promote price cutting, a practice that "directly benefits consumers." *Weyerhaeuser*, slip op. at 5.

Nonprice restraints likewise "threaten fewer harms to competitive interests" than does RPM. AREEDA, *supra*, ¶ 1630b, at 302. By their nature, nonprice restraints are (i) self-limiting, in that they can only rationally apply to certain goods and dealers, and (ii) narrowly tailored to meet their particular procompetitive objectives. On the other hand, RPM is an overly broad and unnecessary means by which to achieve any of the procompetitive benefits of restricted distribution. As a result, it is true that RPM agreements "so often prove so harmful to competition and so rarely prove justified that the antitrust laws do not require proof that an agreement of that kind is, in fact, anticompetitive in the particular circumstances." *NYNEX Corp. v. Discon, Inc.*, 525 U.S. 128, 133 (1998).

B. The Asserted Procompetitive Justifications Do Not Justify RPM

It is said RPM may prevent free-riding, foster brand image, and provide an extra incentive for dealers to carry a producer's unpopular product. While such procompetitive goals may justify imposing other vertical restraints, they cannot justify RPM. Even where theoretically applicable, RPM is a particularly indirect and unreliable method of attaining these goals, all of which can be achieved by far more direct and far less restrictive means.

1. The Free-Rider Problem Does Not Justify RPM

To be sure, the Court has recognized that nonprice vertical restraints may be justified on the basis of ensuring that dealers provide pre-sale services desired by the manufacturer to promote its products. *See Sylvania*, 433 U.S. at 54-55. However, for an overwhelming number of products, the argument that RPM is likewise justifiable is "nonsense." Robert Pitofsky, *Why Dr. Miles Was Right*, 8 REGULATION 27, 29 (1984). The free-rider "problem" does not justify RPM for a number of reasons:

First, implicit in the free-rider justification is that a lower-priced dealer does not or cannot provide the desirable pre-sale services. Thus, the theory fails to account for the more efficient dealer who can both provide desired pre-sale services and save the customer money at the same time. Rather than discouraging free-riding, it will often be the case that RPM will serve to discourage innovation, resulting in higher consumer prices and lower consumer choice, without inducing any added services.

Second, where a retailer is a multibrand outlet, such as supermarket or department store, which is overwhelmingly the case, the "idea that the manufacturer can induce better services or more amenable surroundings by raising

the retail price on one item is ridiculous." Pitofsky, *In Defense of Discounters*, *supra*, at 1493.

Third, the justification is applicable only to those goods for which pre-sale services are potentially desirable, such as were the televisions in *Sylvania*, the herbicides in *Monsanto*, or the calculators in *Sharp*. After all, what pre-sale services could possibly help sell a tube of toothpaste or a bottle of catsup? Allowing RPM to flourish would serve to raise prices for the vast majority of consumers' day-to-day purchases, while only theoretically increasing desired services on infrequently purchased, complex products that comprise only a very small fraction of overall consumer spending.

Fourth, even where potentially applicable, RPM is a particularly indirect way to foster such special services. Such services can be ensured expressly and directly via contract or non-price restraint with great precision, enabling a manufacturer to achieve any intended procompetitive benefit to interbrand competition without the great risk of anticompetitive harm caused by RPM.

Undeterred, Petitioner and its *amici* charge that the rise of Internet commerce has exacerbated the free-rider problem. This argument has it backwards and fails not only to appreciate the procompetitive impact of the Internet, but also to acknowledge the degree to which the Internet is used by both manufacturers and retailers to educate consumers prior to entering the store, rendering on-site pre-sale services less valuable to sellers and to buyers than ever. As the current Chairman of the Federal Trade Commission has recognized:

> The Internet has created enormous benefits for consumers through increased convenience, choice, and efficiency. It empowers consumers by providing them easy access to large amounts of information, allowing them to quickly research and compare product attributes and prices and to purchase products and services from all over the

> country or even the world without leaving home. The expanded choices and increased information that the Internet offers have intensified competition in a number of markets, all of which benefits consumers.

Majoras, *supra*, at 1-2.

As "customers are getting more educated and have better tools, such as the Internet, at their disposal," KOTLER, *supra*, at 23, the free-rider "problem" is not exacerbated but rather is minimized. Where large numbers of consumers are already familiar with products, the value of dealer information services is necessarily diminished. *See, e.g.*, F.M. Scherer, *Vertical Relations in Antitrust: Some Intellectual History*, 49 ANTITRUST BULL. 841, 855 (2004); William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 HARV. L. REV. 983, 1001 (1985). Because of the Internet, today's consumers have access to more product information than ever, making onsite pre-sale services less desirable from the perspective of not only the customer—who often already knows what he wants to buy before going to the store—but also the manufacturer—who has less of a need to subsidize in-store demonstration. This is evidenced by the fact that more and more consumers are foregoing visiting any store at all.

2. Enhancing Product Image Does Not Justify RPM

The class of products to which a brand image justification could plausibly apply is limited to luxury items and the like. For those relatively few products to which the image justification might be applicable, producer advertising and promotion via the mass media generally play a far more substantial role in shaping consumers' brand perception than does retail discounting. In any event, the most direct way to for a producer to safeguard the image of its product, as reflected by its retailer, is to refuse to do business with

discounters, as a matter of right. *See, e.g., Monsanto v. Spray-Rite Servs. Co.*, 465 U.S. 752, 761 (1984) (citing *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919)).

Existing law allows PING and Brighton, as well as Callaway and Prada, for that matter, to achieve their legitimate goals in selling golf clubs or handbags without the need for any relaxation in the law to encourage a practice that experience teaches will inflate the prices for most all other consumer products that have no such "image" to enhance. Adopting a rule of reason would benefit luxury goods manufacturers and dealers at the expense of inflating the prices of groceries to consumers, and thus would be "nothing less than a frontal assault on the basic policy of the Sherman Act." *Prof'l Eng'rs*, 435 U.S. at 695.

3. Increasing Market Penetration Does Not Justify RPM

Finally, RPM is an overly restrictive method by which to achieve market penetration. First of all, manufacturers can always lower their wholesale price to dealers—rather than raise the retail price for dealers—to grant them an increased margin. Additionally, as with brand image, manufacturer advertising can and does serve to create consumer brand awareness for new products. Retailers will inevitably respond to consumer demand by stocking the shelves. Furthermore, manufacturers can and do pay promotional and slotting allowances to entice dealers to carry or display their product. All such practices are a more direct means of promoting interbrand competition without eliminating intrabrand and intertype competition, and the anticompetitive consequences of doing so.

Moreover, in-store promotion is not entirely beneficial. Such promotion often has a tendency to degrade demand quality, as the incentives to retailers and their salespersons generated by RPM may cause them to "push" a particular brand of product regardless of its merit, instead of providing accurate and unbiased information. *See* Warren S. Grimes,

Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited, 80 CAL. L. REV. 815, 832 (1992). In such situations, which happen all too frequently, the manufacturer and the retailer benefit—in the form of increased sales and margins—but it is the consumer who is left holding the bag.

C. A Rule of Reason Will Not Adequately Deter RPM

The "experience of the market has been so clear," *California Dental Ass'n v. FTC*, 526 U.S. 756, 780-81 (1999), that the Court can be confident that RPM almost always raises prices and stifles innovation, and almost never furthers any procompetitive benefit that cannot be achieved by less restrictive means. On the other hand, abandoning the *per se* rule would "lead to far more vertical price fixing than we have now," AREEDA, *supra*, ¶ 1633, at 330, resulting in severe under-deterrence and unwarranted consumer harm.

For all practical purposes, adopting a rule of reason would make RPM virtually legal, for all practical purposes. It is well-known that because of the burdens associated with full rule of reason litigation, it will be the rare instance where a rule of reason RPM case is even brought—no matter how anticompetitive such arrangements might be. Indeed, the rule of reason is "one of the most costly procedures in antitrust practice." HOVENKAMP, THE ANTITRUST ENTERPRISE, *supra*, at 105. Taking on such a heavy burden in prosecuting a case would rarely be justified by the expected value of any outcome and so a lenient rule of reason treatment for RPM "would probably amount to *per se* legality." Pitofsky, *Why Dr. Miles Was Right*, *supra*, at 30. *Cf.* Herbert Hovenkamp, *Vertical Restrictions and Monopoly Power*, 64 B.U. L. REV. 521, 521 (1984). Due to this concern, where, as here, experience has shown a type of agreement to be categorically anticompetitive, "[f]or the sake of business certainty and litigation efficiency," the Court classifies such agreements as illegal

per se, despite the theoretical possibility that there may be some such agreements "that a full blown inquiry might have proved to be reasonable." *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982).

The potential for under-deterrence is amplified by the rule of reason's principal consideration—whether or not a *manufacturer* has market power. In the context of RPM, where it is dealer and not manufacturer power that is often the root cause, such a test "has no meaning." HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra*, § 11.1, at 436. Moreover, this ubiquitous and notoriously difficult to detect dealer power that gives rise to RPM—whether or not the product of an actual conspiracy—cannot by itself be effectively deterred by the *per se* rule against horizontal price fixing. *See* AREEDA, *supra*, ¶ 1604a, at 36. In short, abandoning the *per se* rule against RPM in favor of the rule of reason would "not constitute sound antitrust policy." *Weyerhaeuser*, No. 05-381, slip op. at 5.

IV. THE CONSUMER GOODS PRICING ACT OF 1975 ESTABLISHES THAT RPM SHOULD REMAIN *PER SE* ILLEGAL

After experiencing the effects of RPM during the "fair trade" era, America abandoned RPM. Not long after assuming office, President Ford embarked upon a campaign to unify the country in battling inflation, an integral part of which was a "return to the vigorous enforcement of antitrust laws." Hon. Gerald R. Ford, President of the United States, *Whip Inflation Now* (Oct. 4, 1974), *available at* http://millercenter.virginia.edu/scripps/digitalarchive/conferenceDetail/30. Central to that objective was the repeal of the "fair trade" exemptions. *See* White House Press Release (Jan. 29, 1975), *reprinted in* KINTNER, *supra*, at 953. The initiative was so overwhelmingly popular that Congress was largely "unable to find anyone willing to take a stand" against repeal. Eileen Shannon, *No Defenders of "Fair*

Trade" are Found at Repeal Hearing, N.Y. TIMES, Feb. 19, 1975, at 72.

On December 12, 1975, President Ford signed into law the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, to "make it illegal for manufacturers to fix the prices of consumer products sold by retailers." Hon. Gerald R. Ford, President of the United States, *Presidential Statement Upon Signing H.R. 6971* (Dec. 12, 1975), *reprinted in* KINTNER, *supra*, at 981. The Act reinstated the *per se* rule against RPM, foreclosing the application of the rule of reason. *See California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102 (1980); *Sylvania*, 433 U.S. at 51 n.18. To now adopt a rule of reason for RPM would directly conflict with the language and the import of this amendment, and would otherwise conflict with the stated will of Congress.

A. The Plain Language of the Act Mandates that RPM Remain *Per Se* Illegal

The plain language of the Act, though sparse, is dispositive. By its terms, the Consumer Goods Pricing Act is an "Act to amend the Sherman Antitrust Act to provide lower prices for consumers." Other than the technical provisions setting forth the effective date and repealing the Miller-Tydings and McGuire Acts, the phrase "to provide lower prices for consumers" is the Act's only descriptive language, and is therefore the "key to open the understanding" of this amendment. *Coosaw Mining Co. v. South Carolina*, 144 U.S. 550, 562 (1892).

Failing to "construe the text according to its normal import," *Smith v. United States*, 508 U.S. 223, 244 (1993) (Scalia, J. dissenting), Petitioner and its *amici* advocate a standard of liability that conflicts with this language; for a rule of reason would necessarily allow RPM to be deemed reasonable (and ruled legal) in cases where the practice actually *raises* prices to consumers—exactly the opposite of what the Act calls for. Such an interpretation would

invariably and impermissibly produce "absurd results." *United States v. Wilson*, 503 U.S. 329, 334 (1992).

That the Act itself does not include the term "*per se* illegal" is of no consequence. *See F. Hoffmann-La Roche Ltd. v. Empagran S.A.*, 542 U.S. 155, 163 (2004) (holding FTAIA to pertain to subject matter jurisdiction despite no mention of that term in the statute). Indeed, Congress knows full well how to draft legislation to require federal courts to engage in a rule of reason analysis. *See, e.g.*, 15 U.S.C. § 4302; 35 U.S.C. § 271(d)(5). Moreover, given that the state of the law in 1975 was that RPM was *per se* illegal, by amending the Sherman Act to eliminate the fair trade exemptions, the Act incorporated the *per se* rule into the Sherman Act itself. *See Beck v. Prupis*, 529 U.S. 494, 504 (2000) (holding contemporaneous understanding of elements of civil conspiracy incorporated into the RICO Act).

B. The Legislative History of the Act and Subsequent Legislation Confirm that RPM Should Remain *Per Se* Illegal

Congress ended "fair trade" certain that the effect of the Act would be to make minimum resale price maintenance *per se* illegal. The legislative record is nothing short of compelling. In the Committee Reports and statements on the House and Senate floors, RPM was recognized as "*per se* illegal" on a number of occasions and otherwise referred to in similar terms. For instance, the House Report referred to RPM as "*per se* illegal under Section 1 of the Sherman Act." H. Rep. 341, 94th Cong. (1975), *reprinted in* KINTNER, *supra*, at 956. Similarly, the Senate Report stated that the "fair trade laws are in fact legalized price fixing," and that "[w]ithout these exemptions the agreements they authorize would violate the antitrust laws." S. Rep. 466, 94th Cong. (1975), *reprinted in* KINTNER, *supra*, at 973. On the floor of the House, Representative Rodino referred to such agreements as "*per se* violations of the antitrust laws" and as "classic restraints

of trade." KINTNER, *supra*, at 962. Likewise, Representative Seiberling stated that RPM is a "*per se* violation of the Federal antitrust laws." *Id.* at 968. Other Congressmen and Senators expressed similar sentiments. *See id.* at 961-69, 975-80; *see generally* John F. Seiberling, *Antitrust Law Enforcement in the Vertical Restraints Area: Congress Makes Laws: The Executive Should Enforce Them*, 53 ANTITRUST L.J. 175 (1984). Put simply, "a rule of reason for RPM would clearly undermine Congress' intent." HOVENKAMP, FEDERAL ANTITRUST POLICY, *supra*, § 11.1, at 394.

Not long after the Consumer Goods Pricing Act was enacted, Congress passed still more legislation confirming that that RPM is and should remain *per se* illegal. It prevented the Antitrust Division from arguing in this Court that the *Dr. Miles* rule be overturned, *see Monsanto*, 465 U.S. at 761 n.7, and otherwise expressed disapproval of the Antitrust Division's stance on the rule on a number of occasions. *See generally* Richard M. Steuer, *The Turning Points in Distribution Law*, 35 ANTITRUST BULL. 467, 498-500 (1990); David A. Marks & Jonathan M. Jacobson, *Price Fixing: An Overview*, 30 ANTITRUST BULL. 199, 236-39 (1985). This legislation carries "great weight," *Red Lion Broad. Co. v. FCC*, 395 U.S. 367, 380-381 (1969), in construing Section 1 of the Sherman Act, as amended by the Consumer Goods Pricing Act.

V. *STARE DECISIS* AND COMMON LAW PRINCIPLES COUNSEL IN FAVOR OF RETAINING THE *DR. MILES* RULE

On numerous occasions, the Court has enforced the *per se* rule against RPM since it decided *Dr. Miles*. The *per se* rule has been endorsed by Congress and relied upon by American consumers. Neither Petitioner nor its *amici* present any compelling evidence of the special circumstances required to abandon this venerable precedent. Indeed, America's experience with RPM and the *Dr. Miles* rule counsel in favor of adherence.

A "departure from the doctrine of *stare decisis* demands special justification." *Patterson v. McLean Credit Union,* 491 U.S. 164, 172 (1989). "This is especially true where, as here, the principle has become settled through iteration and reiteration over a long period of time," *Randall v. Sorrell*, 126 S. Ct. 2479, 2489 (2006), and is particularly so where, as is also the case here, the issue has been the subject of "careful, intense, and sustained congressional attention." *Square D Co. v. Niagara Frontier Tariff Bureau, Inc.*, 476 U.S. 409, 424 (1986). It follows that where a settled interpretation setting forth a rule of law has become embedded in the fabric of our nation's culture, it will be upheld. *See, e.g.*, *Dickerson v. United States*, 530 U.S. 428, 443-44 (2000) (upholding requirement that police issue *Miranda* warnings).

The "long accepted practices of the American people," *44 Liquormart*, 517 U.S. at 517 (Scalia, J., concurring), counsel that the *Dr. Miles* rule be preserved. The judicial treatment of RPM "fundamentally affect[s] the day-to-day activities of consumers." Hon. Pamela Jones Harbour, Commissioner, Federal Trade Commission, *Vertical Restraints: Federal and State Enforcement of Vertical Issues*, Address to American Law Inst. and American Bar Ass'n on Product Distribution and Marketing, at 4 (forthcoming Mar. 8, 2007), *available at* http://www.ftc.gov/speeches/harbour.htm. Consumers have relied upon the ability to comparison shop on the basis of price between retailers for decades—whether it be for large purchases, such as automobiles, or smaller purchases such as foodstuffs and sundries. In so doing, they properly "expect that the promise of competitive markets is being met." *Id.* In reliance upon the Court's and Congress' repeated confirmation of the validity of the *Dr. Miles* rule, American consumers have come to depend upon vigorous competition among—and evolutionary innovation by—retailers as the rule of trade and as core to their consuming lives. But for the rule, many of the dynamic developments in distribution that have proven world-changing in the nearly one hundred years

since *Dr. Miles* was decided might never have happened. No justifications have been presented that warrant abandoning the *per se* rule in light of this experience.

The common law tradition invoked by the Sherman Act, *Business Elec's Corp. v. Sharp Elec's Corp.*, 485 U.S. 717, 732 (1988), also counsels in favor of retaining the *Dr. Miles* rule. The common law looks to "experience," as reflected in the "story of a nation's development," rather than "the axioms and corollaries of a book of mathematics." OLIVER WENDELL HOLMES, JR., THE COMMON LAW 1 (1881). The asserted procompetitive benefits of RPM are theoretical and speculative, as well as limited in both their applicability and their necessity. The anticompetitive effects of RPM, however, are proven and plain, applying broadly to all segments of the economy—in both the short and the long term. In deciding whether to retain the *Dr. Miles* rule, the Court should draw upon the "lessons of accumulated experience," *Khan*, 522 U.S. at 20, and be guided not by untested economic theories, but rather by America's experience in enduring the demonstrated anticompetitive effects of resale price maintenance and enjoying the dynamic benefits of the *per se* rule.

Neither special circumstances nor common law principles provide any good reason to now abandon a century of the Court's precedents, in direct conflict with the stated will of Congress and at the expense of the American consumer. Minimum resale price maintenance should remain *per se* illegal.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

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FILED
JAN 22 2007
OFFICE OF THE CLERK

No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., doing business as
Kay's Kloset . . . Kay's Shoes,

Respondent.

On Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

BRIEF OF *AMICI CURIAE* ECONOMISTS IN SUPPORT OF PETITIONER

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January 22, 2007

QUESTION PRESENTED

Should minimum resale price maintenance continue to be deemed *per se* unlawful under Section 1 of the Sherman Act, or, in light of modern economic understanding and antitrust policy, should it instead be subject to the rule of reason, like other vertical price and non-price restraints?

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INTEREST OF *AMICI CURIAE*[1]

Amici, who are listed in the Appendix hereto, are professors and scholars who teach and write on economics, specializing in the economics of industrial organization, competition, and antitrust policy. They include members of the faculties of some of the nation's leading academic institutions. Eight of the *amici* have served as either Director of the Bureau of Economics of the Federal Trade Commission or Deputy Assistant Attorney General for Economic Analysis at the Antitrust Division of the Department of Justice (the highest-ranking economist at each agency).

Amici submit this brief to share with the Court their expertise in the economics of industrial organization, competition, and antitrust policy; to apprise the Court of developments in economic theory and research bearing on the question presented; and to further the goals of achieving economic efficiency, maximizing economic welfare, and adopting antitrust policy consistent with economic principles.

INTRODUCTION AND SUMMARY

The petition in this action addresses the antitrust treatment of minimum resale price maintenance ("RPM") agreements in which an upstream seller agrees with a buyer on the minimum price, or the exact price, at which the buyer will resell the goods. Minimum RPM has been treated as *per se* unlawful under Section 1 of the Sherman Act, 15 U.S.C.

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[1] *Amici* file this brief solely as individuals, and not on behalf of any institutions or organizations with which they are affiliated. No counsel for a party has authored this brief in whole or in part and no person or entity, other than *amici* or their counsel, has made a monetary contribution to the preparation or submission of this brief. Both parties have filed letters with the Court consenting to the filing of all amicus briefs.

§ 1, since *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), except for the years 1937 to 1975 when it was partially exempted from the Sherman Act by statute. *See* Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 3-7 (Bureau of Econ., Fed. Trade Comm'n 1983). Other vertical restraints, including maximum RPM, in which a buyer and seller set a ceiling on the buyer's resale price, as well as almost all non-price vertical agreements, are now analyzed under the rule of reason, although they had previously been considered *per se* illegal. *See State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum RPM); *Cont'l T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical non-price agreements generally).

Amici urge the Court to reverse the decision of the United States Court of Appeals for the Fifth Circuit and hold that minimum RPM is subject to analysis under the rule of reason, rather than being illegal *per se*. This Court has frequently observed that the rule of reason is the presumptive standard for determining the legality of practices challenged as anticompetitive under the Sherman Act. *Per se* condemnation is reserved for conduct that almost never has a procompetitive effect and almost always has an anticompetitive effect.

In the lengthy period since this Court decided *Dr. Miles*, economic analysis of minimum RPM agreements has demonstrated that vertical restrictions between manufacturers and their dealers, including agreements on minimum resale prices, can enhance competition. Consistent with that teaching, this Court has overruled past decisions that held non-price vertical restraints and maximum RPM unlawful *per se*. The same reasoning should now lead this Court to treat minimum RPM in the same manner, thus abandoning an anachronistic distinction that finds no support in sound economic analysis.

RPM can have procompetitive effects under some circumstances, especially where manufacturers seek to deter free riding on welfare-enhancing investments in services by certain retailers. Even where free riding is not an issue, minimum RPM can sometimes be an efficiency-enhancing means to enforce commitments by resellers to invest in sales effort or to manage uncertainty in demand.

The economics literature does not support a conclusion that minimum RPM almost always produces anticompetitive effects. In many cases, interbrand competition precludes a manufacturer from setting resale prices above a competitive level. And regardless of the extent of interbrand competition, a manufacturer has, except in limited circumstances, little incentive to enrich its dealers by inducing them to impose noncompetitive mark-ups on its products. To the contrary, manufacturers generally have an incentive to require minimum mark-ups that will result in enhanced levels of service to increase total sales. That is a procompetitive effect that benefits manufacturers and consumers alike. While minimum RPM can be used in conjunction with a cartel at the manufacturer or dealer level, the economics literature does not indicate that it does so often, much less virtually all the time as would be necessary to justify a *per se* rule. Taken as a whole, the economics literature does not establish that minimum RPM satisfies this Court's strict criteria for *per se* treatment.

In *amici*'s view, moreover, it is important to bring the law governing non-price and price restraints into congruence. From an economics perspective, vertical price and non-price restraints are substantially identical in effect. Not only is there is no justification for treating the two types of restrictions in such a markedly disparate fashion where sound economic analysis fails to support the distinction, but doing so may force businesses to resort to non-price restraints in situations in which price restrictions may

provide the most effective and procompetitive way to ensure efficient conduct by dealers.

ARGUMENT

I. MINIMUM RPM DOES NOT SATISFY THIS COURT'S STANDARD FOR APPLICATION OF THE *PER SE* RULE

A. The *Per Se* Rule Should Apply Only to Conduct that Almost Never Is Procompetitive and Almost Always Is Anticompetitive

This Court has emphasized that antitrust claims are presumptively subject to rule of reason analysis and that *per se* condemnation is limited to a small class of alleged antitrust offenses whose character is well understood and that are virtually invariably harmful to competition. *See Texaco Inc. v. Dagher*, 126 S. Ct. 1276, 1279 (2006). More specifically, the *per se* rule should be applied only to practices that almost invariably have no procompetitive effects and almost invariably have significant anticompetitive effects—or, as the Court has put it, that have a "pernicious effect on competition and lack . . . any redeeming virtue." *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958), *quoted in GTE Sylvania*, 433 U.S. at 58; *see also GTE Sylvania*, 433 U.S. at 50 (finding *per se* rules appropriate for "conduct that is manifestly anticompetitive"); *Broad. Music, Inc. v. CBS, Inc.*, 441 U.S. 1, 19-20 (1979) (prescribing *per se* treatment when a "practice facially appears to be one that would always or almost always tend to restrict competition and decrease output"). Under this formulation, there is no justification for applying the *per se* rule to minimum RPM.

B. Minimum RPM Can Be Procompetitive

RPM agreements include either a specific price at which a product must be resold or a floor below which the reseller

may not price in reselling the product. (Often, as here, the upstream seller is a manufacturer and the reseller is a retailer. Although that is not always the case, *amici* will use the terms "manufacturer" and "retailer" to denote the upstream seller and reseller, respectively.) An RPM agreement establishes a minimum mark-up for the retailer (the difference between the resale price and the wholesale price from the manufacturer).

Generally, a manufacturer wants retail margins to be low; having sold the product to the retailer, it wants the retailing function to be performed as efficiently as possible, with competing retailers, in turn, passing on to consumers the lowest price consistent with retailers' providing desired services and continuing in business. In real-world markets, however, the incentives facing retailers may be out of alignment with those of manufacturers, to the detriment of the manufacturers' ability to compete effectively with the products of competing manufacturers. In such cases, minimum RPM can help to align these incentives and enhance the competitiveness of a manufacturer's product, thereby benefiting consumers.

1. Eliminating "Free Riding"

There is a consensus in the economics literature that minimum RPM can, in certain circumstances, remedy a free-riding problem and thereby increase competition and enhance consumer welfare. There is some dispute in the literature about how commonly and under what circumstances RPM has such effects, but the literature does not suggest that this is a rare or aberrational effect of RPM.

In purchasing many products, consumers value services performed at the retail level—that is, the provision of these services increases the value of the product for consumers, and some consumers are willing to purchase the product with these services, whereas they would not be willing to

purchase the product if the services were not provided. In some situations, "the increase in demand resulting from enhanced service, elicited through a protected retail margin, will more than offset a negative impact on demand of a higher retail price." G. Franklin Mathewson & Ralph A. Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 57, 67 (1998). The result is an increase in total demand and sales. In such cases, consumer welfare generally will also increase compared with the world in which the product is offered at a lower price but without the dealer's services. *See* Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *in* Issues in Competition Law and Policy (ABA Antitrust Section, Wayne Dale Collins ed., forthcoming 2007), *available at* http://www.virginia.edu/economics/papers/mills/RPM for ABA.pdf.

This phenomenon is likely to be most significant in cases for products that are differentiated and therefore are sold on the basis of features and quality as well as price. For example, a digital camera may require that a retailer explain its unique features and quality in order to realize its maximum sales against competing digital cameras with their own unique features, or against film cameras. Or, a fashion item such as the women's accessories at issue in this case may benefit from longer store hours, more convenient or prestigious store locations, better-trained and more enthusiastic employees, or favoritism in shelf placement. From an economics perspective, all of these services can enhance the quality (real or perceived) of the product because they demonstrably have value to consumers. In such cases, investment in retail services can make consumers, as well as manufacturers and retailers, better off.

Market imperfections, however, may lead retailers to offer less than the amount of support that would be best for manufacturers and consumers. The imperfection most

commonly discussed in the economic literature is the so-called "free-rider" problem. Free riders, in this context, are competing retailers that take advantage of the fact that a prospective customer is under no obligation to purchase the product from the retailer that invests in retail-level services. A customer may take advantage of one retailer's informed sales staff, hands-on demonstrations, and convenient shopping locations and hours. Having received the value of those services, the customer may then purchase the product from another retailer that does not provide the same level of service and, therefore, can afford to sell the product for less. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86 (1960); G. Franklin Mathewson & Ralph A. Winter, *The Incentives for Resale Price Maintenance Under Imperfect Competition*, 21 Econ. Inquiry 337 (1983). For example, a customer may inspect, try out, and learn about a particular type of digital camera at a high-end retailer but then purchase the product from a discount retailer, through mail order, or over the internet.

Free riding creates externalities that lead each retailer—and thus retailers collectively—to spend less on service than is optimal. Each retailer's incentive is to invest in service only to the extent that the additional service costs are recouped through *its* increased sales. Some of the increased sales go to the free-riding retailers, and the full-service retailer properly ignores them when computing its gain from spending more on service. It thus spends less on service than would maximize total sales of the manufacturer's product.

Free riding can also take place where the thing of value provided by the higher-priced retailer is not services, but quality "signaling." *See* Overstreet, *supra*, at 56. Some retailers build a reputation for carrying high-quality or cutting-edge merchandise. Building such a reputation requires an investment, not only in product lines, but in the store's reputation through advertising, location, and other

expenditures. *See* Phillip Nelson, *Advertising as Information*, 82 J. Pol. Econ. 729 (1974). These investments in quality signaling also have the potential to be free-ridden upon: consumers can observe that a brand is sold in a store that they believe would sell only high-quality merchandise and, having concluded that the product is therefore of high quality, purchase it at a discount retailer that also carries it. Minimum RPM in this situation, just as in the services context, can protect the investment of the quality-signaling retailer and help ensure that this retailer can continue to fulfill this function, which for some products is of value both to consumers and to manufacturers and enhances interbrand competition. *See* Overstreet, *supra*, at 56-62.

Minimum RPM agreements can ameliorate the free-rider problem by helping ensure that retailers that do not provide service cannot underprice the retailers that do. By mandating a minimum resale price, the manufacturer can calibrate the level of services offered by retailers to the level at which the manufacturer's profits are maximized (which, once the manufacturer has set its price, is when the greatest amount of output is sold). In some instances, full-service retailers may actually charge less under minimum RPM, because they will be assured of more volume that otherwise would have gone to free-riding discounters. In the long run, minimum RPM thus may "reduce the maximum, and possibly the average, price charged" for the product. Mathewson & Winter, *supra*, 21 Econ. Inquiry at 347. Where free riding exists, minimum RPM arrangements generally increase overall consumer welfare. *See id.*; *see also* Elzinga & Mills, *supra*, manuscript at 7-9 (discussing the conditions under which minimum RPM may increase or decrease total welfare). One reason for the likely net procompetitive effect is that, as explained below, manufacturers have strong incentives to avoid prescribing resale prices that increase retailer margins without inducing them to provide desired retail services.

Minimum RPM is not the only method by which manufacturers can address free-riding concerns, but under some circumstances it may be the only practical one or the most competitive one. There are three principal ways other than RPM to address free riding. First, manufacturers can contract with retailers for specific services. However, the nature of marketing and selling is such that it may be difficult to specify completely all of the services that the retailer must perform and the level at which it must perform them. It is also possible that the retailer, rather than the manufacturer, knows which retail-level services will be most effective in maximizing the competitiveness of the product, or that the most effective services will be discovered only through experience with the market and will be more apparent to the retailer than to the manufacturer. Alternatively, manufacturers could charge consumers directly for point-of-sale services. However, that normally is not practical because the services provided by retailers frequently are informational or because there are economies of scale or scope that retailers which sell a range of products can take advantage of, thereby reducing their cost of providing such services. Finally, a manufacturer might use non-price vertical restraints (such as exclusive territories) to preclude *all* competition from free riders. As discussed below, this alternative is more restrictive of competition and perhaps less efficient than minimum RPM.

The potential for RPM to ameliorate a free riding problem and thereby enhance interbrand competition does not mean that it is procompetitive in every case. While alternative methods of curtailing free riding might not, as explained above, always be available or most efficient, where they are RPM may not offer an incremental benefit to interbrand competition that would offset the diminution of intrabrand competition. Moreover, the benefits of RPM may be meager in highly concentrated markets where there is not much interbrand competition to be enhanced. *See* F.M.

Scherer, *Industrial Market Structure and Economic Performance* 542-49 (3d ed. 1990) (showing that RPM may reduce both consumer and social welfare under a plausible hypothesis regarding its impact on demand for the product); Robert L. Steiner, *The Nature of Vertical Restraints*, 30 Antitrust Bull. 143 (1985) (arguing that certain types of vertical restraints, including exclusive dealing coupled with RPM, are especially detrimental to intrabrand competition).

2. Ensuring Dealer Contribution to Product Quality

Even absent free riding, retailers may not be inclined to make the level of investments in service that would maximize the overall competitiveness of a manufacturer's products. According to Klein and Murphy, minimum RPM can help ensure a desired level of investment in retail services. A manufacturer can threaten to terminate a dealer that provides inadequate service, but given the difficulties of monitoring service levels a retailer may be willing to bear the risk of termination rather than incur the cost of providing additional services. It may be less inclined to do so where the risk it faces is losing an RPM-enhanced margin. *See* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & Econ. 265, 265-70 (1988); *see also* Andrew N. Kleit, *Efficiencies Without Economists: The Early Years of Resale Price Maintenance*, 59 S. Econ. J. 597 (1993) (applying the Klein-Murphy theory to RPM cases litigated before the advent of modern economic thought about vertical restraints).

With minimum RPM, retailers' choice of value-added services are determined and disciplined by market competition with other retailers. By eliminating intrabrand price competition among dealers, minimum RPM effectively shifts intrabrand competition to the non-price arena—that is, retailers compete to find the service package that best drives sales of the product. Elzinga & Mills, *supra*, manuscript at

4. This competition benefits consumers, who receive the package of retail-level services most useful to them; benefits retailers that develop the package, and thereby compete successfully against other retailers selling either the same or different products; and benefits the manufacturer, whose sales thereby increase.

3. Managing Demand Uncertainty

There is also support for the proposition that RPM can help to stabilize demand for a product where retailers must order their inventories of the product before demand for it is known. *See* Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997). If demand proves unexpectedly low after retailers have acquired a substantial inventory, prices can plummet as retailers liquidate their holdings. By preventing this precipitous decline, minimum RPM can benefit consumers by encouraging retailers to maintain appropriate inventory levels. Knowing that RPM provides them with some protection in case demand is low, dealers may be willing to place larger orders in advance of knowing the demand, thereby ensuring adequate stocks if demand turns out to be high. Similarly, dealers may be more willing to invest in inventory in more innovative and risky products or styles, which can enhance product variety and benefit competition and consumers.

C. The Economics Literature Does Not Support the Conclusion that Minimum RPM Often, Much Less Invariably, Has an Anticompetitive Effect

1. Minimum RPM's Enhancement of Interbrand Competition Offsets Its Effect on Intrabrand Competition

Minimum RPM inherently restrains intrabrand price competition (competition among resellers of the brand that is

the subject of the agreement). As this Court has recognized, however, the principal form of competition that the antitrust laws encourage is interbrand competition (competition among the products of different manufacturers). *See, e.g., Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724-26 (1988); *GTE Sylvania*, 433 U.S. at 54-55. As noted above, the manufacturer that uses minimum RPM can enhance interbrand competition by causing resellers to provide additional services that will increase the product's competitiveness against other products and increase sales of the product. Thus, even where minimum RPM raises the price charged by a given retailer, that does not mean that there is necessarily an anticompetitive effect. *See Sharp*, 485 U.S. at 728.

In a world of imperfect information, it is, of course, possible that a manufacturer will erroneously prescribe minimum resale prices that are higher than optimal and that will lead to lower, not higher, sales. But the manufacturer has incentives to avoid doing so. It gains no profits from having its dealers charge excessive prices or furnish unwanted service. To the contrary, where the prescribed resale price exceeds the level that optimizes the sales of the brand, the manufacturer is the loser, just as it is where the price is below the optimal level. In the ordinary case, therefore, manufacturers will strive to avoid setting resale prices above what the market calls for. In all events, it is not the function—or capacity—of antitrust law to prevent such errors. That is what markets are for. *See* Elzinga & Mills, *supra*, manuscript at 9 (citing Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 6, 21 (1981)); *see also* Frank H. Easterbrook, *Contract and Copyright*, 42 Hous. L. Rev. 953, 957 (2005) ("Markets are *much* better than judges at sifting efficient from anticompetitive practices." (emphasis in original)).

2. *The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Manufacturer Cartels*

One objection to minimum RPM that had some traction historically is that it might be used to facilitate a cartel at the manufacturer level. There is no reason to believe, however, that this occurs frequently, or that a *per se* rule is needed to address any cases in which it does occur.

Most cartels do not involve manipulation or control of downstream resale prices, but minimum RPM has been proposed as one means by which a cartel can dissuade cheating by its members, which have incentives to reduce prices slightly and thereby gain market share. Cartel members seeking to prevent "cheating" on their agreement ideally would observe each other's prices directly. Market circumstances or prudence, however, may preclude that from happening. As an alternative, manufacturers might agree to impose RPM agreements on their dealers, so that any reduction in price by a manufacturer could not be passed on to the consumer by the retailer, but would enrich only the retailer. With no benefit to consumers, demand for the product would not increase, and the would-be "cheat" would not benefit from its reduced prices.

There are reasons to believe that this type of use of minimum RPM would not be very common.

First, this situation could arise only where manufacturers had agreed to a criminal cartel and where market conditions made such a cartel practical. Thus, it would not apply where a manufacturer is law-abiding or where the number of competing manufacturers, the ease of entry, or other market circumstances rendered a successful cartel implausible. *See* Overstreet, *supra*, at 19-23. *See generally* George Stigler, *A Theory of Oligopoly*, 72 J. Pol. Econ. 44 (1964) (discussing prerequisites for effective horizontal coordination); U.S.

Dep't of Justice & Fed. Trade Comm'n, *Horizontal Merger Guidelines* §§ 2.11, 2.12 (1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 (Apr. 2, 1992) (same).

Second, it would not apply where compliance with a conspiracy can be monitored without RPM. It is noteworthy that minimum RPM has not been generally reported as an enforcement mechanism in the major price-fixing cartels that the Department of Justice has prosecuted in the past decade.

Third, there is no empirical evidence that minimum RPM is used with any frequency in this manner. To the contrary, the empirical evidence that does exist suggests that such use of minimum RPM is not common. In 1991, Pauline Ippolito of the Federal Trade Commission reported a study of the frequency with which both manufacturer cartels and retailer cartels (discussed below) were alleged in the 153 reported minimum RPM cases from 1976 to 1982. *See* Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263 (1991). Ippolito found that only 5.9 percent of the cases involved allegations of horizontal manufacturer price fixing in addition to RPM. She concluded, "[o]n this basis, there is little evidence . . . to support the hypothesis that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM." *Id.* at 281.

3. The Economics Literature Does Not Support the Conclusion that Minimum RPM Is Often Used to Facilitate Reseller Cartels

It also has been suggested that minimum RPM could be used to facilitate reseller cartels. *See* Basil S. Yamey, *Origins of Resale Price Maintenance: A Study of Three Branches of Retail Trade*, 62 Econ. J. 522 (1952). Retailers that sought to form a cartel could induce manufacturers to implement minimum RPM agreements and thereby become the cartel's enforcement mechanism.

For many of the reasons mentioned above with respect to manufacturer conspiracies, the use of minimum RPM to enforce dealer cartels is not likely to be very common. Such a situation would require a retail market with high barriers to entry, because manufacturers would otherwise sell through non-colluding, lower-margin dealers. Cartelization is also an unlikely motive in markets where only one or few competitors implement RPM programs because otherwise consumers could switch to brands not encumbered by collusive retail margins. Moreover, because dealers often can observe each other's prices directly, participation by suppliers in such a cartel through minimum RPM agreements is unlikely to be necessary.

In addition, the manufacturer—a key element in these agreements—receives no benefit from a dealer cartel, but on the contrary, suffers diminished sales. Therefore, manufacturers generally lack incentives to cooperate in furthering a dealer cartel.

As with manufacturer cartels, the empirical evidence lends no support to the suggestion that minimum RPM often facilitates retailer cartels. In Ippolito's 1991 study, only 7.2 percent of the 153 minimum RPM cases reported between 1976 and 1982 contained allegations of collusion among dealers. This contributed to Ippolito's conclusion that "this evidence suggests that, on the margin, a relaxation of the *per se* rule against RPM would primarily affect noncollusive uses of RPM." Ippolito, *supra*, 34 J.L. & Econ. at 282. Overstreet, in a 1983 survey of litigated FTC minimum RPM cases, found that of the 47 cases between 1965 and 1982 for which information was available on retail market structure, 43 involved at least 100 competing retailers, a situation in which "[w]idespread dealer collusion . . . seems unlikely to be effective or persistent" absent certain market conditions. Overstreet, *supra*, at 80. He observed that "[i]t seems reasonable to conclude that for the majority of these (47)

cases the use of RPM was not likely motivated by collusive dealers who had successfully coerced their suppliers into using RPM to facilitate a widespread dealers' cartel." *Id.*

4. *The Disagreements in the Economics Literature Provide No Basis for a* Per Se *Rule*

There is some disagreement within the economics literature, and among *amici*, regarding the frequency with which minimum RPM has procompetitive or anticompetitive effects. Upon careful scrutiny, however, it is apparent that the range of the disagreements underscores that a rule of *per se* illegality should not be applied to minimum RPM.

In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue. The critical issue is the boundaries of that dispute. Some believe that minimum RPM is almost always benign and thus should basically be ignored by antitrust law except when it is part of a cartel case. *See, e.g.*, Elzinga & Mills, *supra*, manuscript at 14-15. Others believe that RPM has been demonstrated to be anticompetitive in some cases and thus merits serious antitrust consideration. *See, e.g.*, F.M. Scherer, *Comment on Cooper et al.'s "Vertical Restrictions and Antitrust Policy,"* 1 Competition Pol'y Int'l 65 (2005); William S. Comanor et al., *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* (Am. Antitrust Inst. Working Paper No. 05-04, Apr. 18, 2005), *available at* http://www.antitrustinstitute.org/recent2/408.pdf. The position absent from the literature is that minimum RPM is most often, much less almost invariably, anticompetitive. Thus, the economics literature provides no support for the application of a *per se* rule.

II. RULE OF REASON TREATMENT OF MINIMUM RPM IS NEEDED TO MAINTAIN DESIRABLE CONSISTENCY BETWEEN PRICE AND NON-PRICE RESTRAINTS

Antitrust law has moved steadily in the direction of evaluating vertical restraints under the rule of reason, and appropriately so. Maximum RPM and all forms of vertical non-price restraints (except, nominally, some tying arrangements) are now subject to assessment under the rule of reason.

Applying the rule of reason to minimum RPM, like almost all other vertical restraints, is appropriate because there is little difference in economic substance between price and non-price restraints. Compare minimum RPM, for example, to territorial exclusivity. Like minimum RPM, exclusive territories relieve dealers of being in price competition with each other as to the same brand of product. Yet, under the present state of the law the former is *per se* illegal whereas the latter is judged under the rule of reason.

This divergent treatment is particularly ironic because to the extent that there is a difference in economic effect between the practices it is that minimum RPM permits *more* competition. As noted, both practices eliminate intrabrand price competition. Minimum RPM, however, unlike exclusive territories, permits intrabrand non-price competition. Moreover, it leaves multiple sellers of the brand in the same geographic market to engage in interbrand competition.

Minimum RPM also may be the more efficient means of solving the free-rider problem. For example, a manufacturer may find it most efficient to have one dealer on each side of a city, because some (but not all) customers shop only on their side of a city. The free-rider problem created by those customers who would travel to the other side for a lower

price could be solved by giving one dealer an exclusive territory covering the entire city, but that solution would be inefficient in that it would forsake those consumers who would not travel across town to the remaining dealer. As compared to the use of minimum RPM to solve the free-rider problem, both the manufacturer and consumers would be worse off.

Amici submit that the Court, therefore, ought to reverse the Fifth Circuit's decision in order to reconcile the standards applicable to price and non-price restraints. There is, to be sure, economic value in precedent. By its nature, however, antitrust is intended to evolve along with economics learning and, as *GTE Sylvania* and *Khan* demonstrate, the Court has not hesitated to abandon decisions whose economic underpinning has been eroded and whose continued existence impedes, as opposed to advances, economic efficiency and consumer welfare. *Amici* respectfully submit that the rule in *Dr. Miles* cannot be reconciled with this Court's analysis in *GTE Sylvania*. By far, a more appropriate rule is to evaluate vertical minimum resale price agreements under the traditional rule of reason standard.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision of the United States Court of Appeals for the Fifth Circuit and overrule the *per se* rule against minimum RPM.

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No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
Petitioner,

v.

PSKS, INC., DOING BUSINESS AS KAY'S KLOSET . . . KAY'S SHOES,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE STATES OF NEW YORK, ALASKA, ARKANSAS, CONNECTICUT, DELAWARE, FLORIDA, HAWAII, IDAHO, ILLINOIS, IOWA, KANSAS, KENTUCKY, LOUISIANA, MAINE, MARYLAND, MASSACHUSETTS, MICHIGAN, MINNESOTA, MISSISSIPPI, MISSOURI, MONTANA, NEVADA, NEW HAMPSHIRE, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, OHIO, OKLAHOMA, OREGON, PENNSYLVANIA, SOUTH CAROLINA, SOUTH DAKOTA, UTAH, VERMONT, WASHINGTON, WEST VIRGINIA, AND WYOMING AS AMICI CURIAE SUPPORTING RESPONDENT

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QUESTION PRESENTED

Whether this Court should overrule *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911), which held that minimum resale price maintenance agreements constitute *per se* violations of the Sherman Act, 15 U.S.C. § 1.

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INTEREST OF AMICI CURIAE

Congress has authorized the Attorneys General of the States to bring federal antitrust actions to protect their citizens from the harmful effects of price-fixing and other anticompetitive conduct. 15 U.S.C. § 15c; *see also Georgia v. Pa. R.R. Co.*, 324 U.S. 439 (1945). The States therefore have a strong interest in ensuring that the courts apply clear and effective standards for liability under the Sherman Act, 15 U.S.C. §§ 1 *et seq.*

The States have a particular interest in preserving the *per se* prohibition against the price-fixing practice challenged here — minimum resale price maintenance ("minimum RPM"). The States vigorously prosecute cases involving minimum RPM agreements. *See, e.g., New York v. Salton, Inc.*, 265 F. Supp. 2d 310 (S.D.N.Y. 2003); *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 216 F.R.D. 197 (D. Me. 2003); *In re Nine West Shoes Antitrust Litig.*, 80 F. Supp. 2d 181 (S.D.N.Y. 2000); *Texas v. Zeneca, Inc.*, 1997-2 Trade Cas. (CCH) ¶ 71,888 (N.D. Tex. June 27, 1997); *Missouri v. Am. Cyanamid Co.*, 1997-1 Trade Cas. (CCH) 71,712 (W.D. Mo. Feb. 7, 1997); *New York v. Reebok Int'l, Ltd.*, 903 F. Supp. 532 (S.D.N.Y. 1995), *aff'd*, 96 F.3d 44 (2d Cir. 1996); *Pennsylvania v. Playmobil USA*, 1995-2 Trade Cas. (CCH) ¶ 71,215 (M.D. Pa. Dec. 15, 1995); *New York v. Keds Corp.*, 1994-1 Trade Cas. (CCH) ¶ 70,549 (S.D.N.Y. Mar. 21, 1994); *Maryland v. Mitsubishi Elecs. Am.*, 1992-1 Trade Cas. (CCH) 69,743 (D. Md. Jan. 15, 1992); *New York v. Nintendo of Am.*, 775 F. Supp. 676 (S.D.N.Y. 1991); *In re Minolta Camera Prods. Antitrust Litig.*, 668 F. Supp. 456 (D. Md. 1987).[1] The States recovered more than $115 million in cash and $75 million in product for consumers in these cases.

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1. Information about these cases is available from the NAAG State Antitrust Litigation Database, http://naag.org/antitrust/search.

SUMMARY OF ARGUMENT

Section 1 of the Sherman Act prohibits any "contract . . . in restraint of trade or commerce." 15 U.S.C. § 1. In *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911), this Court held that a minimum RPM agreement — an agreement not to sell products below a specified minimum price — is *per se* a violation of section 1. *Dr. Miles* was correct when it was decided, and remains sound today, because minimum RPM agreements are direct agreements to raise retail prices, and there is no evidence that they offer any offsetting consumer benefits.

In this case, petitioner — a manufacturer of women's fashion accessories sold primarily in boutique stores — made an agreement with its retailers, including respondent, that they would not sell its products below specified minimum prices. When it learned that respondent had sold its products below the agreed-upon price, it cut off all shipments to respondent.

Petitioner does not dispute that, under *Dr. Miles*, its minimum RPM agreement violated the Sherman Act. Neither petitioner nor its *amici* offer adequate justification for overruling *Dr. Miles* and nearly a century of precedent adhering to it.

A. The available empirical data support *Dr. Miles*'s common-sense conclusion that minimum RPM agreements, by directly eliminating price competition, produce the very anticompetitive effect that the antitrust laws seek to avoid: raising consumer prices. Under "fair trade" laws, minimum RPM agreements were legal in some States from 1931 to 1976. Advocates for these laws championed the interests of merchants, in the form of higher profit margins, over those of consumers, who benefit from lower prices. And as the

economic literature on which petitioner relies acknowledges, the laws succeeded: consumer prices were higher in States that permitted minimum RPM agreements than in States that did not.

B. By contrast, no empirical evidence shows that minimum RPM agreements have offsetting benefits for consumers. Petitioner relies on a body of economic literature that speculates as to the possible procompetitive effects of minimum RPM agreements. But as Judge Easterbrook has explained, "no economic model is worth much without testing." Frank H. Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 151 (1984). Although a model may raise "fascinating intellectual questions, . . . ultimately only good, hard, empirical work can offer answers." *Id.*

Despite widespread academic interest in the subject, no one has answered Judge Easterbrook's call for empirical research. Rather, a "dearth of empirical evidence on the use of" minimum RPM — indeed, an "empirical vacuum" — "seriously limits the development of economic understanding of these practices" and has left "[t]he host of competing theories . . . untested." Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 293 (1991). Untested economic hypotheses, whether promising or not, are no basis for overturning this Court's longstanding precedent.

C. Even if one could imagine hypothetical scenarios in which a minimum RPM agreement might, on balance, benefit consumers, countervailing interests justify continued adherence to the *per se* prohibition. Bright-line rules avert litigation by providing clear guidance to businesses that want to avoid antitrust violations. And litigation under a *per se*

rule is far less costly, and far more manageable, for all parties than litigation under a rule of reason. These considerations outweigh any hypothetical imperfections in the *per se* rule that petitioner asserts.

D. This Court's decisions applying the rule of reason to other vertical restraints, such as maximum RPM, are fully consistent with a *per se* prohibition on minimum RPM. Minimum RPM is different from these other practices. The anticompetitive effect of minimum RPM is direct, obvious, and empirically documented: Minimum RPM raises prices for consumers. By contrast, the anticompetitive effects of maximum RPM and other vertical restraints are neither direct, obvious, nor as fully documented by empirical evidence.

ARGUMENT

Although *stare decisis* is "not an inexorable command," this Court "approach[es] the reconsideration of [its] decisions . . . with the utmost caution." *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997). "*Stare decisis* . . . promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Id.* (citations and quotation marks omitted). The doctrine mandates that "a departure from precedent . . . be supported by some special justification," *Dickerson v. United States*, 530 U.S. 428, 443 (2000) (citation and quotation marks omitted), that is, "some special reason over and above the belief that a prior case was wrongly decided," *Planned Parenthood v. Casey*, 505 U.S. 833, 864 (1992). In interpreting section 1 of the Sherman Act, this Court has overturned prior decisions only when necessary to "adapt[] to changed circumstances and the lessons of accumulated experience." *Khan*, 522 U.S. at 20.

In the ninety-six years since *Dr. Miles*, this Court has repeatedly reaffirmed that minimum RPM agreements violate the Sherman Act *per se*.[2] Petitioner cannot point to either "changed circumstances" or "lessons of accumulated experience" that justify overruling this body of precedent. Parties to a minimum RPM agreement agree to maintain higher prices for consumers than would exist if price competition were allowed. Not surprisingly, "accumulated experience" has taught that minimum RPM agreements achieve their goal of raising prices for consumers. Petitioner's explanation for why higher prices benefit consumers or competition does not draw on practical experience or new empirical studies. Rather, it is based on untested academic speculation. This Court should not overturn longstanding precedent on the basis of unproven hypotheses.

A. The Direct Anticompetitive Effects of Minimum RPM Justify Continued Adherence to the *Per Se* Prohibition.

A century of experience confirms that *Dr. Miles* and the later decisions reaffirming it properly hold minimum RPM agreements *per se* illegal. The "*per se* approach permits categorical judgments with respect to certain business practices that have proved to be predominantly

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2. *E.g.*, *State Oil Co. v. Khan*, 522 U.S. 3, 17 (1997); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988); *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341-43 (1987); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 348 (1982); *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102-02 (1980); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977); *Simpson v. Union Oil Co.*, 377 U.S. 13, 17-18 (1964); *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 386 (1951); *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 720-21 (1944); *United States v. A. Schrader's Son, Inc.*, 252 U.S. 85, 99-100 (1920).

anticompetitive." *Northwest Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 289 (1985); *see also Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (*per se* rules are appropriate "for conduct that ... would always or almost always tend to restrict competition") (citation and quotation marks omitted). A *per se* rule, rather than a rule of reason, may be justified "based on demonstrable economic effect." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977).

1. Minimum RPM agreements merit *per se* treatment because they have demonstrably anticompetitive effects that harm consumers. A minimum RPM agreement directly and intentionally eliminates price competition. It is by definition price-fixing. *See Dr. Miles*, 220 U.S. at 408 (noting that the object of minimum RPM is "destruction of competition and the fixing of prices"). With minimum RPM, suppliers and retailers agree to maintain higher prices than would exist absent the agreement. The intended higher prices are themselves the demonstrable economic effect. *See id.* (noting that "the advantages which the participants expect to derive" entail an "enhanced price to the consumer").

Empirical evidence confirms — if confirmation is needed — the common-sense notion that eliminating price competition has the anticompetitive effect of raising prices. Most of the data come from a natural experiment conducted by the States with federal authorization. From 1931 to 1976, States enacted "fair trade" laws that exempted minimum RPM agreements from federal antitrust scrutiny. *See generally* Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 Res. Econ. Hist. 185 (1996). The laws' supporters believed that minimum RPM agreements would raise consumer prices and retailers' profits. Fair-trade laws were "'urged almost entirely by ... organized dealer groups,'" who hoped to "'eliminat[e] price competition'" and "'to bring pressure to bear on

manufacturers to place products under price maintenance at prices yielding dealer margins satisfactory to cooperating organized dealer groups.'" Thomas R. Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 145 (FTC 1983) (quoting H.R. Rep. No. 94-341 (1975)); *see also* McCraw, *Competition*, *supra*, at 187 (traditional wholesalers and retailers lobbied for legalization of minimum RPM "to shield themselves against new forms of competition"). The retailers lobbying for the laws did not argue that increased prices and profits would promote consumer welfare by, for example, making manufacturers' distribution networks more efficient. Instead, they argued that vigorous competition — and falling consumer prices — were generally bad for the economy and for small businesses. *See* McCraw, *Competition*, *supra*, at 208-09.[3]

The effects of the fair-trade laws on consumer welfare were studied extensively. Academics and government agencies compared prices in fair-trade States to those in "free-trade" States, as the States that continued to prohibit minimum RPM agreements were called. As the economic literature on which petitioner relies acknowledges, empirical studies showed that fair-trade laws, and the minimum RPM agreements that they authorized, achieved their goals: consumer prices went up. *See* Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. Pol. Econ. 1074, 1084 (1986) ("[T]he price evidence ... strongly supports the view that prices in [fair-trade states] were higher than those in free-trade states."); Overstreet, *Resale Price Maintenance*, *supra*, at

3. Other New Deal programs, like the National Industrial Recovery Act, also were based on a skepticism of the value of competition. McCraw, *Competition*, *supra*, at 208-09; *cf.* Charles Van Hise, *Concentration and Control* 226 (1973) (original date of publication 1912) ("[s]ufficient cooperation should be allowed to prevent fierce and unrestrained competition which goes to the extent of reducing prices below a reasonable amount").

160 ("The price surveys indicate that RPM in most cases increased the prices of products sold with RPM.").

A 1956 United States Department of Justice study concluded that consumers in fair-trade States paid from 19 to 27 percent more than consumers in free-trade States. *Quality Stabilization: Hearings Before a Subcomm. of the Senate Comm. on Commerce*, 88th Cong. 6 (1963) (statement of Lee Loevinger, Assistant Attorney General, Antitrust Division, Department of Justice); *see also* Overstreet, *Resale Price Maintenance*, *supra*, at 113 (1970 Department of Justice study found that prices in fair-trade States were up to 37.4 percent higher than in free-trade States). The Department concluded that "the operation of a national price maintenance law . . . would cost the American consumer billions of dollars and have a powerful inflationary effect." *Quality Stabilization*, *supra*, at 6. For example, when Levi Strauss stopped requiring minimum RPM, retail prices for its merchandise plunged. For men's jeans alone, consumers saved an estimated $200 million in eighteen months. *See* William S. Comanor, F.M. Scherer & Robert L. Steiner, *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* 8 (AAI Working Paper No. 05-04, 2005).

2. The link between minimum RPM and higher prices is not disputed by most economists. As Judge Easterbrook has explained, when economists claim that minimum RPM is procompetitive, they nevertheless assume that manufacturers "raise the price" and "increas[e] the dealer's margin" in order to "compensat[e] retailers" for something: "There is no such thing as a free lunch; the manufacturers can't get the dealer to do more without increasing the dealer's margin." Easterbrook, *Vertical Arrangements*, *supra*, at 156. Although offering different explanations for how the consumer supposedly benefits from higher prices, economists almost unanimously accept, and conform their hypotheses

to, the evidence that minimum RPM raises consumer prices and retailer margins.[4]

Petitioner likewise does not seriously dispute the link between minimum RPM and higher consumer prices. While petitioner asserts in passing that minimum RPM need not necessarily lead to higher prices, Pet. Br. at 17 n.7, the primary authority that petitioner cites for this proposition refutes it instead. *See* Marvel & McCafferty, *Political Economy*, *supra*, at 1084 (acknowledging that cross-jurisdictional price surveys "strongly support[]" the conclusion that prices were higher in fair-trade jurisdictions than in free-trade jurisdictions, although offering a theoretical explanation for why multi-state surveys are of little value). And the only "empirical" support petitioner offers is a single study, cited in the Overstreet survey, that found that minimum RPM was accompanied by increases in price among some

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4. *See, e.g.*, Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *available at* http://www.virginia.edu/economics/papers/mills/RPM20for20ABA.pdf ("[m]anufacturers . . . in perfectly competitive markets would never use RPM as a pricing practice"); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 73 (1993) (proceeding from premise that manufacturers use "quasi-rents" to compensate retailers); Easterbrook, *Vertical Arrangements*, *supra*, at 141 (1984) (noting criticism that "resale price maintenance . . . enables manufacturers to jack up the retail price of its products," and responding, "So it does"); Overstreet, *Resale Price Maintenance*, *supra*, at 160 ("both procompetitive and anticompetitive economic theories of RPM predict that price maintenance will usually raise prices"); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 87 (1960) ("a necessary condition to a manufacturer's use of resale price maintenance is that he must possess some degree of monopoly control over the price of the product"); *cf.* Marvel & McCafferty, *Political Economy*, *supra*, at 1075 (offering theory for why RPM might lower prices, but acknowledging that common-sense suggests that "the protection of higher dealer margins . . . would . . . seem to raise prices").

retailers and less significant decreases among others. But Overstreet concluded that the evidence shows that minimum RPM usually leads to price increases; and he expressly noted that economic models assume as much. *See* Overstreet, *Resale Price Maintenance*, *supra*, at 160.

3. The broad acceptance that minimum RPM results in higher prices, as it is intended to do, merits significant weight in deciding whether minimum RPM should be *per se* illegal. "'The protection of price competition from conspiratorial restraint is an object of special solicitude under the antitrust laws.'" *Bus. Elecs. Corp.*, 485 U.S. at 742, 743 n.5 (quoting *United States v. Gen. Motors*, 384 U.S. 127, 148 (1966)). Indeed, this Court has defined unreasonable restraints of trade as those that are "so substantial as to affect market prices." *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 500 (1940).

Thus, far from showing a need to overrule *Dr. Miles*, "lessons of accumulated experience" confirm the holding of that case. *Kahn*, 522 U.S. at 20. Minimum RPM agreements are, after all, agreements not to lower prices. They produce higher prices than would exist without those agreements. Absent substantial evidence that minimum RPM agreements have other procompetitive effects that outweigh the harm of higher prices, they are properly treated as *per se* illegal. That evidence has not been forthcoming.

B. Petitioner Has Not Presented Empirical Evidence That the Higher Prices Caused by Minimum RPM Benefit Consumers or Competition.

Minimum RPM has the obvious and empirically well-documented effect of raising prices. Thus, petitioner, in asking this Court to overturn settled precedent, must defend its counterintuitive claim that higher prices benefit consumers by somehow stimulating competition. Petitioner tries to do

so by arguing that the higher retailer profits that result from minimum RPM agreements "provide incentives for retailers to engage in promotional activities that are necessary to the efficient marketing," or otherwise to "invest in demand-creating services." Pet. Br. at 6-7. This echoes the economic literature, which speculates that minimum RPM agreements — by guaranteeing higher profits and preventing price competition by retailers — encourages retailers to provide additional services such as "pre-sale display, product-specific information, [consumer-friendly] store hours, adequate inventory, post-sale service, ... certifi[cation] of product quality, and other shopping amenities." Elzinga & Mills, *supra*, at 2.

1. But petitioner offers no real-world evidence supporting those assertions. Nor does the economic literature contain empirical support for the belief that minimum RPM has procompetitive effects. Thus, the following observation, made in 1987, continues to be true today: "the basic reason the *per se* rule continues to be accepted is that those . . . who would argue against it[] have not made their case outside of an economic laboratory." Sanford M. Litvack, *The Future Viability of the Current Antitrust Treatment of Vertical Restraints*, 75 Cal. L. Rev. 955, 956 (1987).

Although the procompetitive theories have been discussed by scholars since at least 1960,[5] the literature forthrightly acknowledges that there is an "empirical vacuum" that "seriously limits the development of economic understanding of these practices" and has left "[t]he host of competing theories ... untested."[6] Indeed, much of the

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5. *See* Telser, *Why Should Manufacturers Want Fair Trade?*, *supra* (1960) (advancing "free rider" theory for minimum RPM); *cf. id.* at 86 n.1, 87 n.2, & 89 n.4 (crediting articles going back to 1916).

6. Ippolito, *Resale Price Maintenance*, *supra*, at 293; *see also* Easterbrook, *Vertical Arrangements*, *supra*, at 151 (noting need for (Cont'd)

literature does not even purport to rest its conclusions on empirical work.[7]

This lack of empirical work may reflect that while the direct, negative consumer-welfare effects of minimum RPM are readily observable, the hypothesized procompetitive benefits are too ephemeral to be tested. Advocates of the procompetitive explanations do not even assert that the benefits are measurable empirically.

In this respect, minimum RPM differs sharply from the economic practices at issue in cases in which this Court has abrogated the *per se* rule against price fixing — in favor of rule-of-reason analysis — on the ground that the particular practice at issue arguably conferred benefits on consumers and competition. *See, e.g., Nat'l Collegiate Athletic Ass'n v. Bd. of Regents*, 468 U.S. 85 (1984); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 21-22 (1979). In these cases, the defendants alleged a consumer benefit from collusion that could be empirically verified. They asserted, and this Court agreed, that they were creating entirely new products, whose existence requires some elimination of competition — in *NCAA*, a sports league, and

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(Cont'd)

"empirical work"); Overstreet, *Resale Price Maintenance, supra*, at 1 (no procompetitive hypothesis "is well supported by available empirical evidence"); Richard Posner, *Antitrust Law* 151 (1976) (noting that economists' explanations have not "yet been tested empirically").

7. *See, e.g.*, Herbert Hovenkamp, *Vertical Restrictions and Monopoly Power*, 64 B.U. L. Rev. 521 (1984); Robert Bork, *The Antitrust Paradox* 280-98 (1978); Telser, *Why Should Manufacturers Want Fair Trade?, supra* (identifying no evidence in support of his "free rider" theory); *cf. id.* at 99-104 (discussing evidence supporting explanation that minimum RPM facilitates the creation of cartels).

in *Broadcast Music*, a blanket license. *See NCAA*, 468 U.S. at 101 ("this case involves an industry in which horizontal restraints on competition are essential if the product is to be available at all"); *Broadcast Music*, 441 U.S. at 21-22 (defendant had shown that blanket license offered jointly by individual license holders was "a different product" from that offered individually by license holders). By contrast, petitioner does not claim to have created a new product through minimum RPM and has no real-world evidence that its practices result in any measurable benefits to consumers.

The lack of empirical work may also reflect that the economic models are too inconsistent, general, and imprecise to yield clear predictions — true hypotheses — to test. *See* Karl Popper, *The Logic of Scientific Discovery* 72 (2002) ("a self-contradictory system is uninformative .. . because any conclusion we please can be derived from it" and no particular result "is singled out, either as incompatible or as derivable, since all are derivable"); *id.* at 116 (a theory should be "sufficiently precise to be capable of clashing with observational experience"). The explanations reach the "consensus" that petitioner touts, Pet. at 13, only by glossing over inconsistent premises or remaining at such a high level of generality that they could be thought consistent with almost any set of observed facts.

For example, the literature has not resolved even basic questions about whether, under the procompetitive explanations, one would expect to find evidence of market power at the supplier level in industries in which minimum RPM is used. Petitioner assumes that minimum RPM occurs in competitive interbrand markets. Pet. Br. at 22. This suggests that suppliers who use minimum RPM need not have market power. But much of the literature that petitioner cites posits that suppliers using minimum RPM must have market power — and, in effect, confer some of that power on retailers

in return for preferential treatment.[8] Similarly, the literature has not resolved whether one would expect to find higher-than-competitive returns among retailers subject to minimum RPM agreements. Some scholars assume not. *See* Bork, *The Antitrust Paradox*, *supra*, at 290 ("No manufacturer or supplier will ever use ... [minimum RPM] for the purpose of giving the resellers a greater-than-competitive return."); Hovenkamp, *Vertical Restrictions*, *supra*, at 524 (concluding that minimum RPM will not result in retailer profits beyond an ordinary, competitive market return). Others make the opposite assumption. *See* Winter, *Vertical Control*, *supra*, at 73 (positing that suppliers share "quasi-rents" with retailers in minimum RPM).

One would expect such inconsistencies to make it difficult to test the procompetitive position, and they have. *See* Overstreet, *Resale Price Maintenance*, *supra*, at 12 (notwithstanding the long time that economists have discussed possible procompetitive explanations regarding minimum RPM, the underlying theories "are not precise enough to generate distinctive testable hypotheses."). For example, one cannot draw meaningful conclusions from data about market power or retailer profits — two common indirect indicia of competitive effects — because, as noted above, *some* model is likely to fit the empirical evidence no

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8. *See* Easterbrook, *Vertical Arrangements*, *supra*, at 156 (suppliers must have power over price to confer something of value on retailers that will induce them to give special treatment to suppliers' goods); Overstreet, *Resale Price Maintenance*, *supra*, at 17 ("retailers would have little incentive to extract RPM from manufacturers of products . . . where the manufacturer does not have some market power, unless the dealers are able to induce RPM on all or most competing brands as well"); Telser, *Why Should Manufacturers Want Fair Trade?*, *supra*, at 87 ("a necessary condition to a manufacturer's use of resale price maintenance is that he must possess some degree of monopoly control over the price of the product").

matter what it shows. *See* Pauline M. Ippolito & Thomas R. Overstreet, *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. Law & Econ. 285, 301 (1996) (noting that the "structural evidence . . . typically available in antitrust investigations . . . does not allow tests" of the procompetitive theories). Because the explanations are so malleable that they can generate almost any hypothesis one wants, they cannot be tested with any rigor.

2. In view of these obstacles, it is not surprising that the few empirical studies of procompetitive explanations draw only the weakest conclusions — conclusions that do nothing to advance petitioner's case. Pauline Ippolito's *Resale Price Maintenance* study, *supra* — a review of cases from 1975 and 1982 that involved allegations of minimum RPM agreements — is typical. The study did not test for the hypothesized consumer benefits directly. Instead, it merely tried to determine whether any of the procompetitive explanations had even "limited plausibility" in some of the studied cases. *Id.* at 293. Not surprisingly, Ippolito concluded that she could not entirely rule out the procompetitive explanations. Some cases, for example, involved products as to which the consumer might want more information. *Id.* at 282-85. Others involved products for which the retailer might add something tangible to the product, such as installation or post-sale adjustment. *Id.* at 285-89. Yet others involved products that an especially motivated retailer might be able to persuade a wavering customer to buy. *Id.* at 289-91. But showing that an explanation is merely plausible — in the sense of not obviously incorrect — is a far cry from showing that it is correct. Even Ippolito acknowledges that her analysis did little to fill the "empirical vacuum" in this area. *Id.* at 293.

Other studies are similarly unhelpful to petitioner's position. For example, "the most rigorous and complete empirical evaluation of an application of RPM" involved bread products subject to minimum RPM. Overstreet, *Resale Price Maintenance*, *supra*, at 126. Analysis "showed that the price of bread fell . . . and that the quantity of bread consumed was not adversely affected" when minimum RPM ceased. *Id.* The data thus were "inconsistent with the procompetitive . . . theory." *Id.* Another study found that the output and profit levels of a single company, Corning Glass Works, were higher during periods when it used minimum RPM than when it did not. But the study's scope was so limited that at most it could show, in this one case, that the data were "generally consistent" with procompetitive explanations. Ippolito & Overstreet, *Resale Price Maintenance*, *supra*, at 322.

3. Recognizing the lack of empirical support for their position, proponents of minimum RPM simply assume that there are unobservable benefits. *See* Winter, *Vertical Control*, *supra*, at 69 (noting hypothesis that suppliers are seeking "certif[ication] [of] product quality"); Ippolito, *Resale Price Maintenance*, *supra*, at 286 n. 38 (suggesting that minimum RPM could be justified for milk on the theory that higher margins will induce retailers of milk to provide greater "quality assurance"). Indeed, petitioner goes so far as to suggest that higher prices *are* the benefit consumers receive because consumers who pay more for a product feel better about the product's quality. Pet. Br. at 3 (asserting that putting a product on sale "degrades a manufacturer's brand" in consumers' eyes). There is no evidence, of course, that consumers in fact like paying higher prices. And even if that counterintuitive proposition were true, it still would not mean that on balance consumers are better off with the satisfaction of paying more for something than if they had the extra money to spend on other needs.

C. The Importance of Clear Guidance Provides an Additional Reason To Adhere To *Dr. Miles.*

Even if one could imagine hypothetical situations in which minimum RPM might benefit consumers on balance, that would not be a reason to abandon the *per se* rule that this Court has applied consistently. All that would show is that a *per se* rule might in theory be overbroad. But virtually all *per se* rules have overbreadth potential, and that has not alone been sufficient to undermine their value. For example, one might speculate that horizontal price-fixing could, in unusual circumstances, actually benefit consumers — perhaps, to take petitioner's own suggestion, by raising prices and thus enhancing consumers' perception of a product's quality. Nonetheless, because price is the "central nervous system of the economy," the *per se* rule is applied to horizontal price-fixing. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224, 226 n.59 (1940).

Countervailing interests make the *per se* rule against minimum RPM appropriate even if it is not perfectly tailored. The *per se* rule, unlike the rule of reason, makes it clear at the outset what the Sherman Act prohibits. *See N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958). Bright lines make it possible for attorneys to advise their clients in advance what they may or may not do, thus avoiding litigation in the first place. And when there is litigation, the *per se* rule obviates the need for "an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable — an inquiry so often wholly fruitless when undertaken." *Id.*; *see also* Easterbrook, *Vertical Arrangements, supra*, at 155 ("Litigation costs are the product of vague rules combined with high stakes, and nowhere is that combination more deadly than in antitrust litigation under the rule of reason.").

As frequent enforcers of the Sherman Act, the States are acutely aware of the benefits of clear standards. Antitrust lawsuits are by their nature difficult, complicated cases. Litigation under the rule of reason, rather than under the *per se* rule, is almost always more protracted and expensive for all involved. And if, as here, the potential for overbreadth is speculative at best, the benefits of a simple rule outweigh whatever theoretical imperfection inures in the *per se* rule. *Cf. Bus. Elecs. Corp.*, 485 U.S. at 723 (noting that the *per se* rule is appropriate "for conduct that ... would always *or almost always* tend to restrict competition" (emphasis added) (internal citation and quotation marks omitted)).

D. Applying the *Per Se* Rule Against Minimum RPM Is Consistent With Testing Other Vertical Restraints Against the Rule of Reason.

Minimum RPM is fundamentally different from other vertical restraints, such as territorial restrictions and maximum RPM, that are subject to the rule of reason. In deciding whether to apply the rule of reason or the *per se* rule, this Court has focused on "demonstrable economic effect." *Continental T.V.*, 433 U.S. at 59. For minimum RPM, as explained above, higher consumer prices are the demonstrable economic effect. Any supposedly procompetitive effects, by contrast, are speculative.

Other vertical restraints, however, may not always — or even usually — have the same uniform and direct harmful effect on consumers. For example, it is not obvious whether territorial restrictions on retailers ultimately raise or lower consumer prices. *See id.* at 51-56. Because both the anticompetitive and procompetitive effects of the practice are speculative, it is appropriate to apply the rule of reason. *Id.* at 57. Similarly, this Court explained that prohibiting maximum RPM agreements — agreements between a

supplier and retailer not to charge consumer *more* than a specified amount for a product — might prevent "lower prices" for consumers, which are "the very essence of competition" and a demonstrable consumer benefit. *Kahn*, 522 U.S. at 15 (citations and quotation marks omitted). Recognizing that maximum RPM also could have anticompetitive effects, this Court again applied the rule of reason. *Id.* at 16-18.

These other vertical restraints can, under some circumstances, have anticompetitive effects, but they also sometimes have demonstrable procompetitive effects. The rule of reason allows the courts to consider all the relevant circumstances in distinguishing good practices from bad ones. By contrast, minimum RPM has an obvious anticompetitive effect — higher prices. No one has found evidence of a procompetitive benefit, despite petitioner's strenuous claim that such a benefit exists. The *per se* prohibition is thus fully justified.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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No. 06-480

IN THE

Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC., DOING BUSINESS AS KAY'S KLOSET . . . KAY'S SHOES,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE STATES OF NEW YORK, ALASKA, ARKANSAS, CONNECTICUT, DELAWARE, FLORIDA, HAWAII, IDAHO, ILLINOIS, IOWA, KANSAS, KENTUCKY, LOUISIANA, MAINE, MARYLAND, MASSACHUSETTS, MICHIGAN, MINNESOTA, MISSISSIPPI, MISSOURI, MONTANA, NEVADA, NEW HAMPSHIRE, NEW JERSEY, NEW MEXICO, NORTH CAROLINA, OHIO, OKLAHOMA, OREGON, PENNSYLVANIA, SOUTH CAROLINA, SOUTH DAKOTA, UTAH, VERMONT, WASHINGTON, WEST VIRGINIA, AND WYOMING AS AMICI CURIAE SUPPORTING RESPONDENT

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QUESTION PRESENTED

Whether this Court should overrule *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911), which held that minimum resale price maintenance agreements constitute *per se* violations of the Sherman Act, 15 U.S.C. § 1.

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INTEREST OF AMICI CURIAE

Congress has authorized the Attorneys General of the States to bring federal antitrust actions to protect their citizens from the harmful effects of price-fixing and other anticompetitive conduct. 15 U.S.C. § 15c; *see also Georgia v. Pa. R.R. Co.*, 324 U.S. 439 (1945). The States therefore have a strong interest in ensuring that the courts apply clear and effective standards for liability under the Sherman Act, 15 U.S.C. §§ 1 *et seq.*

The States have a particular interest in preserving the *per se* prohibition against the price-fixing practice challenged here — minimum resale price maintenance ("minimum RPM"). The States vigorously prosecute cases involving minimum RPM agreements. *See, e.g., New York v. Salton, Inc.*, 265 F. Supp. 2d 310 (S.D.N.Y. 2003); *In re Compact Disc Minimum Advertised Price Antitrust Litig.*, 216 F.R.D. 197 (D. Me. 2003); *In re Nine West Shoes Antitrust Litig.*, 80 F. Supp. 2d 181 (S.D.N.Y. 2000); *Texas v. Zeneca, Inc.*, 1997-2 Trade Cas. (CCH) ¶ 71,888 (N.D. Tex. June 27, 1997); *Missouri v. Am. Cyanamid Co.*, 1997-1 Trade Cas. (CCH) 71,712 (W.D. Mo. Feb. 7, 1997); *New York v. Reebok Int'l, Ltd.*, 903 F. Supp. 532 (S.D.N.Y. 1995), *aff'd*, 96 F.3d 44 (2d Cir. 1996); *Pennsylvania v. Playmobil USA*, 1995-2 Trade Cas. (CCH) ¶ 71,215 (M.D. Pa. Dec. 15, 1995); *New York v. Keds Corp.*, 1994-1 Trade Cas. (CCH) ¶ 70,549 (S.D.N.Y. Mar. 21, 1994); *Maryland v. Mitsubishi Elecs. Am.*, 1992-1 Trade Cas. (CCH) 69,743 (D. Md. Jan. 15, 1992); *New York v. Nintendo of Am.*, 775 F. Supp. 676 (S.D.N.Y. 1991); *In re Minolta Camera Prods. Antitrust Litig.*, 668 F. Supp. 456 (D. Md. 1987).[1] The States recovered more than $115 million in cash and $75 million in product for consumers in these cases.

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1. Information about these cases is available from the NAAG State Antitrust Litigation Database, http://naag.org/antitrust/search.

SUMMARY OF ARGUMENT

Section 1 of the Sherman Act prohibits any "contract . . . in restraint of trade or commerce." 15 U.S.C. § 1. In *Dr. Miles Medical Co. v. John D. Park & Sons*, 220 U.S. 373 (1911), this Court held that a minimum RPM agreement — an agreement not to sell products below a specified minimum price — is *per se* a violation of section 1. *Dr. Miles* was correct when it was decided, and remains sound today, because minimum RPM agreements are direct agreements to raise retail prices, and there is no evidence that they offer any offsetting consumer benefits.

In this case, petitioner — a manufacturer of women's fashion accessories sold primarily in boutique stores — made an agreement with its retailers, including respondent, that they would not sell its products below specified minimum prices. When it learned that respondent had sold its products below the agreed-upon price, it cut off all shipments to respondent.

Petitioner does not dispute that, under *Dr. Miles*, its minimum RPM agreement violated the Sherman Act. Neither petitioner nor its *amici* offer adequate justification for overruling *Dr. Miles* and nearly a century of precedent adhering to it.

A. The available empirical data support *Dr. Miles*'s common-sense conclusion that minimum RPM agreements, by directly eliminating price competition, produce the very anticompetitive effect that the antitrust laws seek to avoid: raising consumer prices. Under "fair trade" laws, minimum RPM agreements were legal in some States from 1931 to 1976. Advocates for these laws championed the interests of merchants, in the form of higher profit margins, over those of consumers, who benefit from lower prices. And as the

economic literature on which petitioner relies acknowledges, the laws succeeded: consumer prices were higher in States that permitted minimum RPM agreements than in States that did not.

B. By contrast, no empirical evidence shows that minimum RPM agreements have offsetting benefits for consumers. Petitioner relies on a body of economic literature that speculates as to the possible procompetitive effects of minimum RPM agreements. But as Judge Easterbrook has explained, "no economic model is worth much without testing." Frank H. Easterbrook, *Antitrust Law Enforcement in the Vertical Restraints Area: Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 151 (1984). Although a model may raise "fascinating intellectual questions, . . . ultimately only good, hard, empirical work can offer answers." *Id.*

Despite widespread academic interest in the subject, no one has answered Judge Easterbrook's call for empirical research. Rather, a "dearth of empirical evidence on the use of" minimum RPM — indeed, an "empirical vacuum" — "seriously limits the development of economic understanding of these practices" and has left "[t]he host of competing theories . . . untested." Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 293 (1991). Untested economic hypotheses, whether promising or not, are no basis for overturning this Court's longstanding precedent.

C. Even if one could imagine hypothetical scenarios in which a minimum RPM agreement might, on balance, benefit consumers, countervailing interests justify continued adherence to the *per se* prohibition. Bright-line rules avert litigation by providing clear guidance to businesses that want to avoid antitrust violations. And litigation under a *per se*

rule is far less costly, and far more manageable, for all parties than litigation under a rule of reason. These considerations outweigh any hypothetical imperfections in the *per se* rule that petitioner asserts.

D. This Court's decisions applying the rule of reason to other vertical restraints, such as maximum RPM, are fully consistent with a *per se* prohibition on minimum RPM. Minimum RPM is different from these other practices. The anticompetitive effect of minimum RPM is direct, obvious, and empirically documented: Minimum RPM raises prices for consumers. By contrast, the anticompetitive effects of maximum RPM and other vertical restraints are neither direct, obvious, nor as fully documented by empirical evidence.

ARGUMENT

Although *stare decisis* is "not an inexorable command," this Court "approach[es] the reconsideration of [its] decisions . . . with the utmost caution." *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997). "*Stare decisis* . . . promotes the evenhanded, predictable, and consistent development of legal principles, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Id.* (citations and quotation marks omitted). The doctrine mandates that "a departure from precedent . . . be supported by some special justification," *Dickerson v. United States*, 530 U.S. 428, 443 (2000) (citation and quotation marks omitted), that is, "some special reason over and above the belief that a prior case was wrongly decided," *Planned Parenthood v. Casey*, 505 U.S. 833, 864 (1992). In interpreting section 1 of the Sherman Act, this Court has overturned prior decisions only when necessary to "adapt[] to changed circumstances and the lessons of accumulated experience." *Khan*, 522 U.S. at 20.

In the ninety-six years since *Dr. Miles*, this Court has repeatedly reaffirmed that minimum RPM agreements violate the Sherman Act *per se*.[2] Petitioner cannot point to either "changed circumstances" or "lessons of accumulated experience" that justify overruling this body of precedent. Parties to a minimum RPM agreement agree to maintain higher prices for consumers than would exist if price competition were allowed. Not surprisingly, "accumulated experience" has taught that minimum RPM agreements achieve their goal of raising prices for consumers. Petitioner's explanation for why higher prices benefit consumers or competition does not draw on practical experience or new empirical studies. Rather, it is based on untested academic speculation. This Court should not overturn longstanding precedent on the basis of unproven hypotheses.

A. The Direct Anticompetitive Effects of Minimum RPM Justify Continued Adherence to the *Per Se* Prohibition.

A century of experience confirms that *Dr. Miles* and the later decisions reaffirming it properly hold minimum RPM agreements *per se* illegal. The "*per se* approach permits categorical judgments with respect to certain business practices that have proved to be predominantly

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2. *E.g.*, *State Oil Co. v. Khan*, 522 U.S. 3, 17 (1997); *Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 724 (1988); *324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341-43 (1987); *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 761 (1984); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 348 (1982); *Cal. Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 102-02 (1980); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 51 n.18 (1977); *Simpson v. Union Oil Co.*, 377 U.S. 13, 17-18 (1964); *United States v. Parke, Davis & Co.*, 362 U.S. 29, 47 (1960); *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 386 (1951); *United States v. Bausch & Lomb Optical Co.*, 321 U.S. 707, 720-21 (1944); *United States v. A. Schrader's Son, Inc.*, 252 U.S. 85, 99-100 (1920).

anticompetitive." *Northwest Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co.*, 472 U.S. 284, 289 (1985); *see also Bus. Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723 (1988) (*per se* rules are appropriate "for conduct that ... would always or almost always tend to restrict competition") (citation and quotation marks omitted). A *per se* rule, rather than a rule of reason, may be justified "based on demonstrable economic effect." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977).

1. Minimum RPM agreements merit *per se* treatment because they have demonstrably anticompetitive effects that harm consumers. A minimum RPM agreement directly and intentionally eliminates price competition. It is by definition price-fixing. *See Dr. Miles*, 220 U.S. at 408 (noting that the object of minimum RPM is "destruction of competition and the fixing of prices"). With minimum RPM, suppliers and retailers agree to maintain higher prices than would exist absent the agreement. The intended higher prices are themselves the demonstrable economic effect. *See id.* (noting that "the advantages which the participants expect to derive" entail an "enhanced price to the consumer").

Empirical evidence confirms — if confirmation is needed — the common-sense notion that eliminating price competition has the anticompetitive effect of raising prices. Most of the data come from a natural experiment conducted by the States with federal authorization. From 1931 to 1976, States enacted "fair trade" laws that exempted minimum RPM agreements from federal antitrust scrutiny. *See generally* Thomas K. McCraw, *Competition and "Fair Trade": History and Theory*, 16 Res. Econ. Hist. 185 (1996). The laws' supporters believed that minimum RPM agreements would raise consumer prices and retailers' profits. Fair-trade laws were "'urged almost entirely by . . . organized dealer groups,'" who hoped to "'eliminat[e] price competition'" and "'to bring pressure to bear on

manufacturers to place products under price maintenance at prices yielding dealer margins satisfactory to cooperating organized dealer groups.'" Thomas R. Overstreet, *Resale Price Maintenance: Economic Theories and Empirical Evidence* 145 (FTC 1983) (quoting H.R. Rep. No. 94-341 (1975)); *see also* McCraw, *Competition*, *supra*, at 187 (traditional wholesalers and retailers lobbied for legalization of minimum RPM "to shield themselves against new forms of competition"). The retailers lobbying for the laws did not argue that increased prices and profits would promote consumer welfare by, for example, making manufacturers' distribution networks more efficient. Instead, they argued that vigorous competition — and falling consumer prices — were generally bad for the economy and for small businesses. *See* McCraw, *Competition*, *supra*, at 208-09.[3]

The effects of the fair-trade laws on consumer welfare were studied extensively. Academics and government agencies compared prices in fair-trade States to those in "free-trade" States, as the States that continued to prohibit minimum RPM agreements were called. As the economic literature on which petitioner relies acknowledges, empirical studies showed that fair-trade laws, and the minimum RPM agreements that they authorized, achieved their goals: consumer prices went up. *See* Howard P. Marvel & Stephen McCafferty, *The Political Economy of Resale Price Maintenance*, 94 J. Pol. Econ. 1074, 1084 (1986) ("[T]he price evidence ... strongly supports the view that prices in [fair-trade states] were higher than those in free-trade states."); Overstreet, *Resale Price Maintenance*, *supra*, at

3. Other New Deal programs, like the National Industrial Recovery Act, also were based on a skepticism of the value of competition. McCraw, *Competition*, *supra*, at 208-09; *cf.* Charles Van Hise, *Concentration and Control* 226 (1973) (original date of publication 1912) ("[s]ufficient cooperation should be allowed to prevent fierce and unrestrained competition which goes to the extent of reducing prices below a reasonable amount").

160 ("The price surveys indicate that RPM in most cases increased the prices of products sold with RPM.").

A 1956 United States Department of Justice study concluded that consumers in fair-trade States paid from 19 to 27 percent more than consumers in free-trade States. *Quality Stabilization: Hearings Before a Subcomm. of the Senate Comm. on Commerce*, 88th Cong. 6 (1963) (statement of Lee Loevinger, Assistant Attorney General, Antitrust Division, Department of Justice); *see also* Overstreet, *Resale Price Maintenance*, *supra*, at 113 (1970 Department of Justice study found that prices in fair-trade States were up to 37.4 percent higher than in free-trade States). The Department concluded that "the operation of a national price maintenance law . . . would cost the American consumer billions of dollars and have a powerful inflationary effect." *Quality Stabilization*, *supra*, at 6. For example, when Levi Strauss stopped requiring minimum RPM, retail prices for its merchandise plunged. For men's jeans alone, consumers saved an estimated $200 million in eighteen months. *See* William S. Comanor, F.M. Scherer & Robert L. Steiner, *Vertical Antitrust Policy as a Problem of Inference: The Response of the American Antitrust Institute* 8 (AAI Working Paper No. 05-04, 2005).

2. The link between minimum RPM and higher prices is not disputed by most economists. As Judge Easterbrook has explained, when economists claim that minimum RPM is procompetitive, they nevertheless assume that manufacturers "raise the price" and "increas[e] the dealer's margin" in order to "compensat[e] retailers" for something: "There is no such thing as a free lunch; the manufacturers can't get the dealer to do more without increasing the dealer's margin." Easterbrook, *Vertical Arrangements*, *supra*, at 156. Although offering different explanations for how the consumer supposedly benefits from higher prices, economists almost unanimously accept, and conform their hypotheses

to, the evidence that minimum RPM raises consumer prices and retailer margins.[4]

Petitioner likewise does not seriously dispute the link between minimum RPM and higher consumer prices. While petitioner asserts in passing that minimum RPM need not necessarily lead to higher prices, Pet. Br. at 17 n.7, the primary authority that petitioner cites for this proposition refutes it instead. *See* Marvel & McCafferty, *Political Economy*, *supra*, at 1084 (acknowledging that cross-jurisdictional price surveys "strongly support[]" the conclusion that prices were higher in fair-trade jurisdictions than in free-trade jurisdictions, although offering a theoretical explanation for why multi-state surveys are of little value). And the only "empirical" support petitioner offers is a single study, cited in the Overstreet survey, that found that minimum RPM was accompanied by increases in price among some

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4. *See, e.g.*, Kenneth G. Elzinga & David E. Mills, *The Economics of Resale Price Maintenance*, *available at* http://www.virginia.edu/economics/papers/mills/RPM20for20ABA.pdf ("[m]anufacturers . . . in perfectly competitive markets would never use RPM as a pricing practice"); Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q.J. Econ. 61, 73 (1993) (proceeding from premise that manufacturers use "quasi-rents" to compensate retailers); Easterbrook, *Vertical Arrangements*, *supra*, at 141 (1984) (noting criticism that "resale price maintenance . . . enables manufacturers to jack up the retail price of its products," and responding, "So it does"); Overstreet, *Resale Price Maintenance*, *supra*, at 160 ("both procompetitive and anticompetitive economic theories of RPM predict that price maintenance will usually raise prices"); Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 87 (1960) ("a necessary condition to a manufacturer's use of resale price maintenance is that he must possess some degree of monopoly control over the price of the product"); *cf.* Marvel & McCafferty, *Political Economy*, *supra*, at 1075 (offering theory for why RPM might lower prices, but acknowledging that common-sense suggests that "the protection of higher dealer margins . . . would . . . seem to raise prices").

retailers and less significant decreases among others. But Overstreet concluded that the evidence shows that minimum RPM usually leads to price increases; and he expressly noted that economic models assume as much. *See* Overstreet, *Resale Price Maintenance*, *supra*, at 160.

3. The broad acceptance that minimum RPM results in higher prices, as it is intended to do, merits significant weight in deciding whether minimum RPM should be *per se* illegal. "'The protection of price competition from conspiratorial restraint is an object of special solicitude under the antitrust laws.'" *Bus. Elecs. Corp.*, 485 U.S. at 742, 743 n.5 (quoting *United States v. Gen. Motors*, 384 U.S. 127, 148 (1966)). Indeed, this Court has defined unreasonable restraints of trade as those that are "so substantial as to affect market prices." *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 500 (1940).

Thus, far from showing a need to overrule *Dr. Miles*, "lessons of accumulated experience" confirm the holding of that case. *Kahn*, 522 U.S. at 20. Minimum RPM agreements are, after all, agreements not to lower prices. They produce higher prices than would exist without those agreements. Absent substantial evidence that minimum RPM agreements have other procompetitive effects that outweigh the harm of higher prices, they are properly treated as *per se* illegal. That evidence has not been forthcoming.

B. Petitioner Has Not Presented Empirical Evidence That the Higher Prices Caused by Minimum RPM Benefit Consumers or Competition.

Minimum RPM has the obvious and empirically well-documented effect of raising prices. Thus, petitioner, in asking this Court to overturn settled precedent, must defend its counterintuitive claim that higher prices benefit consumers by somehow stimulating competition. Petitioner tries to do

so by arguing that the higher retailer profits that result from minimum RPM agreements "provide incentives for retailers to engage in promotional activities that are necessary to the efficient marketing," or otherwise to "invest in demand-creating services." Pet. Br. at 6-7. This echoes the economic literature, which speculates that minimum RPM agreements — by guaranteeing higher profits and preventing price competition by retailers — encourages retailers to provide additional services such as "pre-sale display, product-specific information, [consumer-friendly] store hours, adequate inventory, post-sale service, ... certifi[cation] of product quality, and other shopping amenities." Elzinga & Mills, *supra*, at 2.

1. But petitioner offers no real-world evidence supporting those assertions. Nor does the economic literature contain empirical support for the belief that minimum RPM has procompetitive effects. Thus, the following observation, made in 1987, continues to be true today: "the basic reason the *per se* rule continues to be accepted is that those . . . who would argue against it[] have not made their case outside of an economic laboratory." Sanford M. Litvack, *The Future Viability of the Current Antitrust Treatment of Vertical Restraints*, 75 Cal. L. Rev. 955, 956 (1987).

Although the procompetitive theories have been discussed by scholars since at least 1960,[5] the literature forthrightly acknowledges that there is an "empirical vacuum" that "seriously limits the development of economic understanding of these practices" and has left "[t]he host of competing theories ... untested."[6] Indeed, much of the

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5. *See* Telser, *Why Should Manufacturers Want Fair Trade?*, *supra* (1960) (advancing "free rider" theory for minimum RPM); *cf. id.* at 86 n.1, 87 n.2, & 89 n.4 (crediting articles going back to 1916).

6. Ippolito, *Resale Price Maintenance*, *supra*, at 293; *see also* Easterbrook, *Vertical Arrangements*, *supra*, at 151 (noting need for

(Cont'd)

literature does not even purport to rest its conclusions on empirical work.[7]

This lack of empirical work may reflect that while the direct, negative consumer-welfare effects of minimum RPM are readily observable, the hypothesized procompetitive benefits are too ephemeral to be tested. Advocates of the procompetitive explanations do not even assert that the benefits are measurable empirically.

In this respect, minimum RPM differs sharply from the economic practices at issue in cases in which this Court has abrogated the *per se* rule against price fixing — in favor of rule-of-reason analysis — on the ground that the particular practice at issue arguably conferred benefits on consumers and competition. *See, e.g., Nat'l Collegiate Athletic Ass'n v. Bd. of Regents*, 468 U.S. 85 (1984); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 21-22 (1979). In these cases, the defendants alleged a consumer benefit from collusion that could be empirically verified. They asserted, and this Court agreed, that they were creating entirely new products, whose existence requires some elimination of competition — in *NCAA*, a sports league, and

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(Cont'd)

"empirical work"); Overstreet, *Resale Price Maintenance, supra*, at 1 (no procompetitive hypothesis "is well supported by available empirical evidence"); Richard Posner, *Antitrust Law* 151 (1976) (noting that economists' explanations have not "yet been tested empirically").

7. *See, e.g.*, Herbert Hovenkamp, *Vertical Restrictions and Monopoly Power*, 64 B.U. L. Rev. 521 (1984); Robert Bork, *The Antitrust Paradox* 280-98 (1978); Telser, *Why Should Manufacturers Want Fair Trade?, supra* (identifying no evidence in support of his "free rider" theory); *cf. id.* at 99-104 (discussing evidence supporting explanation that minimum RPM facilitates the creation of cartels).

in *Broadcast Music*, a blanket license. *See NCAA*, 468 U.S. at 101 ("this case involves an industry in which horizontal restraints on competition are essential if the product is to be available at all"); *Broadcast Music*, 441 U.S. at 21-22 (defendant had shown that blanket license offered jointly by individual license holders was "a different product" from that offered individually by license holders). By contrast, petitioner does not claim to have created a new product through minimum RPM and has no real-world evidence that its practices result in any measurable benefits to consumers.

The lack of empirical work may also reflect that the economic models are too inconsistent, general, and imprecise to yield clear predictions — true hypotheses — to test. *See* Karl Popper, *The Logic of Scientific Discovery* 72 (2002) ("a self-contradictory system is uninformative .. . because any conclusion we please can be derived from it" and no particular result "is singled out, either as incompatible or as derivable, since all are derivable"); *id.* at 116 (a theory should be "sufficiently precise to be capable of clashing with observational experience"). The explanations reach the "consensus" that petitioner touts, Pet. at 13, only by glossing over inconsistent premises or remaining at such a high level of generality that they could be thought consistent with almost any set of observed facts.

For example, the literature has not resolved even basic questions about whether, under the procompetitive explanations, one would expect to find evidence of market power at the supplier level in industries in which minimum RPM is used. Petitioner assumes that minimum RPM occurs in competitive interbrand markets. Pet. Br. at 22. This suggests that suppliers who use minimum RPM need not have market power. But much of the literature that petitioner cites posits that suppliers using minimum RPM must have market power — and, in effect, confer some of that power on retailers

in return for preferential treatment.[8] Similarly, the literature has not resolved whether one would expect to find higher-than-competitive returns among retailers subject to minimum RPM agreements. Some scholars assume not. *See* Bork, *The Antitrust Paradox*, *supra*, at 290 ("No manufacturer or supplier will ever use . . . [minimum RPM] for the purpose of giving the resellers a greater-than-competitive return."); Hovenkamp, *Vertical Restrictions*, *supra*, at 524 (concluding that minimum RPM will not result in retailer profits beyond an ordinary, competitive market return). Others make the opposite assumption. *See* Winter, *Vertical Control*, *supra*, at 73 (positing that suppliers share "quasi-rents" with retailers in minimum RPM).

One would expect such inconsistencies to make it difficult to test the procompetitive position, and they have. *See* Overstreet, *Resale Price Maintenance*, *supra*, at 12 (notwithstanding the long time that economists have discussed possible procompetitive explanations regarding minimum RPM, the underlying theories "are not precise enough to generate distinctive testable hypotheses."). For example, one cannot draw meaningful conclusions from data about market power or retailer profits — two common indirect indicia of competitive effects — because, as noted above, *some* model is likely to fit the empirical evidence no

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8. *See* Easterbrook, *Vertical Arrangements*, *supra*, at 156 (suppliers must have power over price to confer something of value on retailers that will induce them to give special treatment to suppliers' goods); Overstreet, *Resale Price Maintenance*, *supra*, at 17 ("retailers would have little incentive to extract RPM from manufacturers of products . . . where the manufacturer does not have some market power, unless the dealers are able to induce RPM on all or most competing brands as well"); Telser, *Why Should Manufacturers Want Fair Trade?*, *supra*, at 87 ("a necessary condition to a manufacturer's use of resale price maintenance is that he must possess some degree of monopoly control over the price of the product").

matter what it shows. *See* Pauline M. Ippolito & Thomas R. Overstreet, *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. Law & Econ. 285, 301 (1996) (noting that the "structural evidence ... typically available in antitrust investigations ... does not allow tests" of the procompetitive theories). Because the explanations are so malleable that they can generate almost any hypothesis one wants, they cannot be tested with any rigor.

2. In view of these obstacles, it is not surprising that the few empirical studies of procompetitive explanations draw only the weakest conclusions — conclusions that do nothing to advance petitioner's case. Pauline Ippolito's *Resale Price Maintenance* study, *supra* — a review of cases from 1975 and 1982 that involved allegations of minimum RPM agreements — is typical. The study did not test for the hypothesized consumer benefits directly. Instead, it merely tried to determine whether any of the procompetitive explanations had even "limited plausibility" in some of the studied cases. *Id.* at 293. Not surprisingly, Ippolito concluded that she could not entirely rule out the procompetitive explanations. Some cases, for example, involved products as to which the consumer might want more information. *Id.* at 282-85. Others involved products for which the retailer might add something tangible to the product, such as installation or post-sale adjustment. *Id.* at 285-89. Yet others involved products that an especially motivated retailer might be able to persuade a wavering customer to buy. *Id.* at 289-91. But showing that an explanation is merely plausible — in the sense of not obviously incorrect — is a far cry from showing that it is correct. Even Ippolito acknowledges that her analysis did little to fill the "empirical vacuum" in this area. *Id.* at 293.

Other studies are similarly unhelpful to petitioner's position. For example, "the most rigorous and complete empirical evaluation of an application of RPM" involved bread products subject to minimum RPM. Overstreet, *Resale Price Maintenance*, *supra*, at 126. Analysis "showed that the price of bread fell . . . and that the quantity of bread consumed was not adversely affected" when minimum RPM ceased. *Id.* The data thus were "inconsistent with the procompetitive . . . theory." *Id.* Another study found that the output and profit levels of a single company, Corning Glass Works, were higher during periods when it used minimum RPM than when it did not. But the study's scope was so limited that at most it could show, in this one case, that the data were "generally consistent" with procompetitive explanations. Ippolito & Overstreet, *Resale Price Maintenance*, *supra*, at 322.

3. Recognizing the lack of empirical support for their position, proponents of minimum RPM simply assume that there are unobservable benefits. *See* Winter, *Vertical Control*, *supra*, at 69 (noting hypothesis that suppliers are seeking "certif[ication] [of] product quality"); Ippolito, *Resale Price Maintenance*, *supra*, at 286 n. 38 (suggesting that minimum RPM could be justified for milk on the theory that higher margins will induce retailers of milk to provide greater "quality assurance"). Indeed, petitioner goes so far as to suggest that higher prices *are* the benefit consumers receive because consumers who pay more for a product feel better about the product's quality. Pet. Br. at 3 (asserting that putting a product on sale "degrades a manufacturer's brand" in consumers' eyes). There is no evidence, of course, that consumers in fact like paying higher prices. And even if that counterintuitive proposition were true, it still would not mean that on balance consumers are better off with the satisfaction of paying more for something than if they had the extra money to spend on other needs.

C. The Importance of Clear Guidance Provides an Additional Reason To Adhere To *Dr. Miles.*

Even if one could imagine hypothetical situations in which minimum RPM might benefit consumers on balance, that would not be a reason to abandon the *per se* rule that this Court has applied consistently. All that would show is that a *per se* rule might in theory be overbroad. But virtually all *per se* rules have overbreadth potential, and that has not alone been sufficient to undermine their value. For example, one might speculate that horizontal price-fixing could, in unusual circumstances, actually benefit consumers — perhaps, to take petitioner's own suggestion, by raising prices and thus enhancing consumers' perception of a product's quality. Nonetheless, because price is the "central nervous system of the economy," the *per se* rule is applied to horizontal price-fixing. *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 224, 226 n.59 (1940).

Countervailing interests make the *per se* rule against minimum RPM appropriate even if it is not perfectly tailored. The *per se* rule, unlike the rule of reason, makes it clear at the outset what the Sherman Act prohibits. *See N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958). Bright lines make it possible for attorneys to advise their clients in advance what they may or may not do, thus avoiding litigation in the first place. And when there is litigation, the *per se* rule obviates the need for "an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable — an inquiry so often wholly fruitless when undertaken." *Id.*; *see also* Easterbrook, *Vertical Arrangements*, *supra*, at 155 ("Litigation costs are the product of vague rules combined with high stakes, and nowhere is that combination more deadly than in antitrust litigation under the rule of reason.").

As frequent enforcers of the Sherman Act, the States are acutely aware of the benefits of clear standards. Antitrust lawsuits are by their nature difficult, complicated cases. Litigation under the rule of reason, rather than under the *per se* rule, is almost always more protracted and expensive for all involved. And if, as here, the potential for overbreadth is speculative at best, the benefits of a simple rule outweigh whatever theoretical imperfection inures in the *per se* rule. *Cf. Bus. Elecs. Corp.*, 485 U.S. at 723 (noting that the *per se* rule is appropriate "for conduct that ... would always *or almost always* tend to restrict competition" (emphasis added) (internal citation and quotation marks omitted)).

D. Applying the *Per Se* Rule Against Minimum RPM Is Consistent With Testing Other Vertical Restraints Against the Rule of Reason.

Minimum RPM is fundamentally different from other vertical restraints, such as territorial restrictions and maximum RPM, that are subject to the rule of reason. In deciding whether to apply the rule of reason or the *per se* rule, this Court has focused on "demonstrable economic effect." *Continental T.V.*, 433 U.S. at 59. For minimum RPM, as explained above, higher consumer prices are the demonstrable economic effect. Any supposedly procompetitive effects, by contrast, are speculative.

Other vertical restraints, however, may not always — or even usually — have the same uniform and direct harmful effect on consumers. For example, it is not obvious whether territorial restrictions on retailers ultimately raise or lower consumer prices. *See id.* at 51-56. Because both the anticompetitive and procompetitive effects of the practice are speculative, it is appropriate to apply the rule of reason. *Id.* at 57. Similarly, this Court explained that prohibiting maximum RPM agreements — agreements between a

supplier and retailer not to charge consumer *more* than a specified amount for a product — might prevent "lower prices" for consumers, which are "the very essence of competition" and a demonstrable consumer benefit. *Kahn*, 522 U.S. at 15 (citations and quotation marks omitted). Recognizing that maximum RPM also could have anticompetitive effects, this Court again applied the rule of reason. *Id.* at 16-18.

These other vertical restraints can, under some circumstances, have anticompetitive effects, but they also sometimes have demonstrable procompetitive effects. The rule of reason allows the courts to consider all the relevant circumstances in distinguishing good practices from bad ones. By contrast, minimum RPM has an obvious anticompetitive effect — higher prices. No one has found evidence of a procompetitive benefit, despite petitioner's strenuous claim that such a benefit exists. The *per se* prohibition is thus fully justified.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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No. 06-480

Supreme Court, U.S.
FILED
JAN 2 2 2007
OFFICE OF THE CLERK

In The
Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,

Petitioner,

v.

PSKS, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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INTEREST OF *AMICUS CURIAE*

PING, Inc. submits this brief *amicus curiae* to provide a unique, real-world view of the extraordinary lengths to which a company must go to implement and administer a vertical minimum resale pricing policy that complies with *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), and *United States v. Colgate & Co.*, 250 U.S. 300 (1919). In 2004, PING unilaterally adopted, and since has unilaterally administered, a vertical minimum resale advertising and pricing policy, referred to as the PING "*i*FIT Pricing Policy." PING developed the *i*FIT Pricing Policy to ensure that its retailers have the resources and incentives necessary to service and custom fit consumers who choose to purchase PING's golf products.[1]

Since PING adopted the *i*FIT Pricing Policy in 2004, it has:

- Spent several million dollars to administer the Policy;
- Employed as many as 12 full-time people to administer the Policy;
- Unilaterally terminated nearly 1,000 PING retailers that violated the Policy – retailers that had generated millions of dollars of revenue for PING prior to their closures; and

[1] Letters of consent to the filing of any and all *amicus curiae* briefs have been filed with the Clerk by petitioner and respondent. No counsel for any party authored this brief in whole or in part, and no person or entity, other than *amicus curiae*, made a monetary contribution to the preparation or submission of this brief. Sup. Ct. R. 37.6.

- Strained its relations with PING retailers and the golfing community in general through its enforcement of the Policy.

PING continues the *i*FIT Pricing Policy, despite these burdensome consequences, because it allows PING to provide its unique products and services to its customers and to preserve its brand, and its special niche, in the highly competitive golf-equipment marketplace.

The purpose of this brief is to demonstrate the advisability of allowing companies like PING to enter into an agreement with retailers regarding the minimum price that can be charged for their products – an agreement that would be subject to a rule of reason analysis as to its legal propriety, and evaluated by the marketplace as to its economic viability. Allowing manufacturers to enter into such agreements with retailers would enhance consumer choice and eliminate the uncertainties and inefficiencies associated with the current, law-driven focus a manufacturer must employ to avoid even a "perception" of a pricing agreement between it and its retailers.

Other *amici*, including distinguished economists and associations of affected businesses, have presented or will present a comprehensive review of the relevant legal theories and economic issues raised by the current law. PING has elected to share this overview of important details of its *i*FIT Pricing Policy through this brief *amicus curiae* because it believes that reviewing a living *Colgate* program will assist the Court in its reevaluation of the *per se* rule against vertical minimum resale price maintenance agreements and demonstrate why the status quo should not be maintained.

SUMMARY OF THE ARGUMENT

Experience has taught PING that, to ensure sufficient incentive for retailers to provide consumers the level of service on which PING has built its brand, and to prevent free riders, the minimum resale price of its products needs to be protected. Under the rule of *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911), PING cannot protect the resale price of its products by entering into an agreement with a retailer to set the minimum price at which the retailer will resell PING's products. Under *United States v. Colgate & Co.*, 250 U.S. 300 (1919), however, PING may try to achieve that result by unilaterally establishing and announcing a retail price list and then summarily terminating retailers that sell below the listed prices. PING unilaterally adopted, and unilaterally administers, its *i*FIT Pricing Policy to comply with these century-old precedents.

As detailed below, to ensure that none of its nearly 10,000 retailers incorrectly imply or conclude that they have entered into any "agreement" with PING regarding the *i*FIT Pricing Policy, PING has adopted numerous, detailed internal procedures, compliance with which is costly and inefficient. In particular, all but a very small group of PING's employees are subject to termination if they communicate in any way with retailers or others about the Policy. Communications from retailers to PING regarding the *i*FIT Pricing Policy are not addressed by marketing professionals; they are funneled instead to antitrust attorneys and paralegals. These individuals handle the delicate and awkward task of dealing with questions and/or comments from often-irate retailers. Each conversation is carefully worded to avoid any suggestion of, or even an unintended perception of, any "agreement."

These efforts are undertaken at great expense to PING. Rather than contributing to the quality of PING's products, the efficiency of its production systems, the development of new products to increase consumer choice, or the provision of consumer services, these measures serve *only* to help PING avoid an antitrust lawsuit.

Aside from the extraordinary costs in labor and oversight, PING's efforts to ensure compliance with *Dr. Miles* and *Colgate* also inject significant and unnecessary strain into PING's relationship with its retailers. For example, if a retailer, unwittingly or otherwise, violates the *i*FIT Pricing Policy, PING does not confer with the retailer to discuss corrective measures. Rather, to avoid any appearance of the sort of "agreement" on which current law fixates, PING's *i*FIT Pricing Policy requires termination of the retailer's account. Since 2004, PING has terminated summarily nearly 1,000 accounts that have violated the Policy even though this "zero tolerance" approach has meant the loss of some of its most successful and popular retailers, with the consequent reduction in the number of outlets at which consumers can obtain PING products.

In sum, PING's *i*FIT Pricing Policy, developed to protect its brand and promote interbrand competition, unnecessarily restricts communication with retailers, damages PING's relationships with retailers and consumers, and creates significant costs and inefficiencies – all because of the need to ensure compliance with *Dr. Miles* and *Colgate* in order to avoid potential *per se* antitrust liability. These effects hurt PING and its retailers and *limit* consumer choice. PING offers golf consumers a real choice – the custom fitting of clubs by PING retailers – that it cannot effectively accomplish without a minimum

resale pricing policy. The antitrust laws should promote, not hinder, this type of non-price competition offered for the benefit of consumers. *Dr. Miles*, therefore, should be overruled.

ARGUMENT

I. PING UNILATERALLY ADOPTED ITS PRICING POLICY FOR PROCOMPETITIVE REASONS.

This Court has long recognized that there are sound economic reasons for manufacturers to want to influence the resale prices of their retail distributors:

> The manufacturer often will want to ensure that its distributors earn sufficient profit to pay for programs such as hiring and training additional salesmen or demonstrating the technical features of the product, and will want to see that "free-riders" do not interfere.

Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 762-63 (1984). It was precisely these kinds of procompetitive factors that led PING to adopt its minimum resale pricing policy, referred to as the *i*FIT Pricing Policy.

Nearly 50 years ago, Karsten Solheim, PING's founder, recognized that consumers should have more, and better, choices when purchasing golf clubs. Working from his garage, Karsten developed what became the PING 1-A Putter, and not long after, Karsten's innovative designs began to change the golf industry. Karsten, his family (which continues to own and operate PING), and the many employees since hired by his company (which now employs roughly 1,000 people), pioneered custom fitting, perimeter

weighting, and other innovations that have greatly added to consumer choice, and have contributed mightily to the game of golf.

As a result of these efforts over the past half-century, the PING brand is now widely recognized as representing innovation, quality, and service, allowing PING to succeed in the extremely competitive golf-equipment marketplace. This success, in turn, affords PING the tools it needs to continue to innovate and to provide golfers with more, and better, choices when purchasing golf clubs and other golf equipment.

Custom fitting has been a key to PING's competitive success. Over the years PING has developed, and improved upon, numerous processes and products that assist a retailer in properly fitting a golfer with PING equipment tailored to that golfer's individual game, regardless of his or her skill level. PING has trained thousands of retailers, bringing them to its Phoenix, Arizona, factory to attend custom-fitting courses. PING also devotes enormous time and resources to educating retailers about PING products, new technologies, and its custom fitting manufacturing process and quality controls. PING believes that retailers that invest their time and resources learning about its products, and in training to be excellent custom fitters, will be better prepared to compete successfully in this key area of customer service. As a result of these efforts, consumer surveys have repeatedly ranked PING as the leader in custom fitting.[2]

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[2] A PING custom fitting identifies which, of the more than one million custom manufacturing possibilities PING can deliver, is the right one for each individual golfer. An iron and wedge fitting session

(Continued on following page)

Several years ago, free rider activity and other retail behavior, exacerbated by internet sales, began to threaten the hard-earned reputation of the PING brand, diminishing the demand for its products, and harming PING consumers. For example, some price-cutting PING retailers were advising consumers to visit a retailer that had invested in PING's custom-fitting program, request a custom-fitting session, and then take the specifications for the custom-made PING clubs back to the discounter for a "great deal," financed by the investments and efforts of the servicing dealer that performed the custom fitting. PING recognized that if such activities were allowed to continue unabated, most, if not all, of PING's retailers would lose any incentive to perform custom fittings and other services that are key to the PING brand and its ability to compete in the marketplace. By 2004, PING's revenues reflected these harmful activities.

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requires 30 to 60 minutes to evaluate properly each golfer's physical characteristics and swing in arriving at the golf club specifications unique to that golfer. The fitting involves: an **interview process** (to identify the golfer's current and desired ball flight); **static measurements** (height and other physical measurements necessary to calculate a starting point for club length, lie angle, and grip size); **a dynamic swing test** ("impact tape" is applied to the sole of the club, and the marks left on the tape are used to calculate the proper loft and lie angles); **ball flight observations** (ball flight is observed to determine the final lie angle specifications – which will minimize the chance that the golfer hits shots that miss left or right of the intended target); and **performance monitor** (the PING "Performance Scoresheet" is employed to identify any changes to the golfer's shot making patterns). As a result of this technical and time-intensive effort, PING customers who have been custom fitted receives the precise clubs that will allow them to "play their best," and obtain all of the value built into PING golf clubs.

PING determined that it could address this problem by ensuring that its retailers had sufficient economic incentive "to provide service and repair facilities necessary to the efficient marketing of their products." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 (1977) (acknowledging procompetitive benefits of vertical restrictions and observing that absent such restrictions, "[b]ecause of market imperfections such as the so-called 'free rider' effect, these services might not be provided by retailers"). Under existing law, PING's only option was to adopt a unilateral *Colgate* pricing policy. PING did so, and in the summer of 2004 informed PING retailers of the *i*FIT Pricing Policy, announcing to its retailers that it would close accounts that advertised or sold certain new PING products for a price less than that identified by PING.[3]

The *i*FIT Pricing Policy is essential to PING's ability to provide its unique products and services to its customers and, thus, to its very ability to engage in this form of interbrand non-price competition. *See, e.g., 324 Liquor Corp. v. Duffy*, 479 U.S. 335, 341-42 (1987) (recognizing "the possibility that a vertical restraint imposed by a *single* manufacturer or wholesaler may stimulate interbrand competition even as it reduces intrabrand competition") (citation omitted). PING, like many other businesses throughout the country, is proud to employ American workers in its manufacturing operations. Given its relatively

[3] A central feature of the *i*FIT Pricing Policy is the "Orange & Blue List" on which PING sets forth its unilaterally established minimum advertising and resale prices for particular new PING products. In the *i*FIT Pricing Policy, PING also unilaterally announced that it would close accounts that sold certain PING products from web sites (with the exception of sales by a handful of PING Authorized Internet Retailers from web sites previously approved by PING).

small size as compared to its largest competitors, PING has chosen not to compete solely on the basis of price, with its attendant focus on cost reduction and the potential for exporting manufacturing jobs and other functions overseas. The *i*FIT Pricing Policy enables PING and its retailers to engage in non-price competition that enhances consumer choice and interbrand competition. *See State Oil Co. v. Khan*, 522 U.S. 3, 15 (1997) (the "primary purpose of the antitrust laws is to protect interbrand competition").

II. TO MINIMIZE ITS RISK OF LIABILITY UNDER *DR. MILES*, PING MUST TAKE EXTRAORDINARY AND INEFFICIENT MEASURES TO ADMINISTER ITS PRICING POLICY THAT HARM, RATHER THAN BENEFIT, CONSUMERS.

Colgate recognizes PING's right unilaterally to establish prices for its products and to refuse to deal with retailers that fail to comply with its *i*FIT Pricing Policy. *E.g., Colgate*, 250 U.S. at 307 ("[T]he [Sherman] [A]ct does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal. And, of course, he may announce in advance the circumstances under which he will refuse to sell."); *see also Monsanto*, 465 U.S. at 761 ("Under *Colgate*, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply. And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination.").

Proponents of maintaining the *per se* illegality of all vertical minimum retail price maintenance agreements tout the "freedom" that *Colgate* supposedly provides as a "vehicle for manufacturers to lawfully exercise some

control over resale prices." Respondent's Brief in Opposition, No. 06-480, 2006 WL 3244036, at *9 (filed Nov. 6, 2006). Others have touted the advantage of a supposed "bright-line" rule. In fact, PING's actual experience shows that this freedom and clarity are not easily attained, in view of the extraordinary measures a company must take to administer a minimum pricing policy in the legal minefield created by *Colgate* and its progeny.[4]

To minimize the risks created by *Colgate*, PING drastically restricts employees' communications with the retailers to whom they sell and, worse, summarily terminates retailers for even the smallest policy violations, without considering whether the violation was intentional or why it occurred. PING employs as many as 12 full-time people who work on the *i*FIT Pricing Policy and related matters and has spent millions of dollars on the administration of the Policy since 2004. These measures and investments do not increase consumer choice, trigger innovation, or otherwise benefit consumers or competition – the ultimate concerns of the antitrust laws. To the contrary, they impose great costs on PING, its retailers, and consumers, most of which could be avoided if PING

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[4] *Compare, e.g., The Jeanery, Inc. v. James Jeans, Inc.*, 849 F.2d 1148 (9th Cir. 1988) (insufficient evidence of agreement to create jury question where manufacturer enforced suggested price policy, distributor threatened to cease purchasing goods from manufacturer unless price-cutting competitor was terminated, and representative of manufacturer reported to complaining distributor that he would "take care of things," then terminated discounter), *with Helicopter Support Sys., Inc. v. Hughes Helicopter, Inc.*, 818 F.2d 1530 (11th Cir. 1987) (sufficient evidence to go to jury where competing dealer complained about price-cutting plaintiff, manufacturer terminated plaintiff and advised complaining dealer of the termination, in response to which complaining dealer sent "thank you" letter to manufacturer).

were allowed the option to enter into pricing agreements with its retailers evaluated under the rule of reason.

A. The Current Law Severely Limits PING's Ability To Communicate With Its Retailers Regarding The *i*FIT Pricing Policy.

In order to avoid any discussion that might arguably be characterized as an agreement, PING funnels all communication (written and oral) related to the *i*FIT Pricing Policy to one of its in-house lawyers or his staff, all of whom are trained with respect to antitrust issues. All other PING employees, including its Sales Representatives, who would be capable of addressing the legitimate questions retailers might have about the *i*FIT Pricing Policy, are instructed not to engage in communications with accounts on this subject.[5]

This environment engenders substantial frustration for PING's nearly 10,000 retail accounts, whose primary contact at PING is one of PING's Sales Representatives, when that Sales Representative refuses to answer questions about the *i*FIT Pricing Policy. PING believes it must impose such constraints to minimize the risk that one of its employees, who is not trained in the legal technicalities of *Dr. Miles* and *Colgate*, will unintentionally make a

[5] For example, retailers may question whether – without violating the *i*FIT Pricing Policy – they can charge for fitting and then credit the amount towards the purchase price without violating the Policy, whether they can give away free golf balls in connection with the sale of PING golf equipment without violating the Policy, or whether they can donate PING golf equipment to a charity without violating the Policy. For fear of crossing an otherwise amorphous line into agreement, all such questions are referred to PING's legal staff.

poorly worded comment that might create the misperception of a forbidden "agreement."

In fact, PING employees face termination if they initiate or engage in any communication with anyone outside of PING about any of the following topics: the *i*FIT Pricing Policy, any potential or actual violation of the Policy, the status of any terminated account, or the prices at which any PING account chooses to advertise or sell new PING products.[6] Further, if a retailer raises any of these topics, PING employees are instructed to provide a pre-printed card that states "I am prohibited from discussing this with you." The card informs the retailer of an "800" number which connects the retailer with lawyers and paralegals for answers to questions about the *i*FIT Pricing Policy. The card also identifies a web site where the retailer can access documents providing detailed answers to a variety of hypothetical situations and "Frequently Asked Questions" about the Policy.

When PING adopted the *i*FIT Pricing Policy in 2004, it required its Sales Representatives to hand-deliver a copy of the Policy to each of their assigned PING retailers and to inform the retailers that Sales Representatives are prohibited from discussing the Policy. The retailers were instructed instead to call the 800 number or consult the website in the event of questions. One PING retailer described these legalistic gymnastics as follows:

> And, when [my PING Sales Representative] originally brought this policy to us in 2004(?) it was the most bizarre presentation ever. He

[6] To date, five employees have been terminated for having violated this communication prohibition.

> handed it to me. I looked at it and tried to ask questions . . . all he kept saying was "I CAN'T TALK ABOUT PRICE" – "I CAN'T TELL YOU ANYTHING ABOUT THAT" . . . about 3 or 4 times I tried to ask different questions about it, but he couldn't or wouldn't talk about it. I felt left alone to fend for ourselves.[7]

As this comment makes clear, concern about the risks of violating *Dr. Miles* and *Colgate* distorts normal communications and substantially damages the retail relationships that PING Sales Representatives have worked hard to cultivate.

Nearly every business day, PING's in-house lawyer and his staff spend several hours drafting replies to emails that are carefully worded to avoid any perception of any agreement between PING and a retailer regarding retail prices. For example, if an email received from a retailer uses language that arguably could indicate that the retailer was attempting to "agree" with PING's *i*FIT Pricing Policy, PING provides a legally-driven, impersonal response that often frustrates retailers:

> I recognize that the questions you asked, and the information you provided, in your email are not in any way intended to indicate any approval, agreement or any other assurance of compliance with respect to the *i*FIT Pricing Policy. However, if that was in any way your intent, please note that it is, and always will be, expressly rejected by PING. PING specifically provides at Section II of the *i*FIT Pricing Policy that: "PING does not

[7] Letter from Joanne Schroeder of Highway #8 Golf Center to Bill Gates of PING, dated October 14, 2006.

> seek, and will not accept, any account's approval, agreement or any other assurance of compliance with respect to this *i*FIT Pricing Policy and/or the Orange & Blue List." You need to decide on your own what you charge for the PING products you sell.[8]

No procompetitive interest is served when PING's lawyers spend hours each day drafting emails filled with antitrust-driven disclaimers and qualifiers in response to simple questions from retailers.

Similarly, PING unilaterally observes the advertising and pricing practices of its retailers and will not accept or act on communications from a retailer providing information about the advertising or pricing practices of any other PING retailer. This ensures that PING is not perceived as acting in concert with one retailer regarding the account status of another retailer. PING typically responds to such communications by disregarding the information the retailer has provided:

> The reason I am responding is because PING employees are prohibited from discussing with you, among other things, your observations regarding the advertising, internet or pricing practices of other PING accounts. Because your August 15 email contains such an observation, the only copy of it kept by PING will be in my files, together with this response. . . . Thank you in advance for not including observations of this

[8] Email from Bill Gates of PING to Ken Horn of Pro Golf San Antonio, dated January 6, 2007.

> nature in your future communications with PING.[9]

Once again, such communications, driven solely by concern about legal risks under *Dr. Miles* and *Colgate*, serve only to undermine PING's longstanding relationships with its retailers and do nothing to enhance marketplace competition.

B. The Current Law Requires PING To Take Uniform And Drastic Action Against Retailers, With No Benefit To Consumers.

Under *Colgate*, PING cannot discuss, without risk, potential corrective measures with retailers, and it therefore enforces its *i*FIT Pricing Policy by terminating all retailers that violate PING's unilaterally set pricing terms – to its own detriment and that of retailers and consumers. PING does not warn its retailers when it becomes aware of a violation; it does not contact the retailer to investigate whether the violation was intentional; it does not consider how long that retailer has been a PING account or the size of the retailer's sales numbers. PING simply closes the account. In fact, PING has closed accounts with nearly *one thousand* PING retailers during the past 30 months. PING sold millions of dollars of golf equipment to these retailers the year before their closures.

As indicated, PING makes no exceptions in the administration of its *i*FIT Pricing Policy. If a retailer violates the Policy, it will be closed regardless of its identity, longevity, or volume of sales. For example, PING closed the

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[9] Email from Bill Gates of PING to Tom Bell of Golf USA, dated August 22, 2006.

account of the country club in Phoenix once owned by PING, and which still serves as the home club of many PING employees, including its CEO and Chairman of the Board. PING also closed the accounts of several golf retailers located on military bases. These terminations led to significant negative media attention in outlets as varied as Golfweek, USA Today and The San Jose Mercury News.[10]

Absent the artificial requirements imposed by the current state of the law, many of PING's account closures might have been avoided, and consumers would not have suffered the attendant reduction in outlets offering the choice of PING products. If permitted to do so without fear of a *per se* violation of the Sherman Act, PING could choose whether to take further measures to educate PING retailers regarding the *i*FIT Pricing Policy, such as warning retailers who violate the *i*FIT Pricing Policy before summarily closing them or giving its retailers an opportunity to correct the violation before losing all access to PING products, a loss that harms not only the retailer, but all of its customers as well. All of these options present substantial risks, however, under the current antitrust regime.[11]

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[10] *See, e.g.*, "Ping's pricing policy sparks PR fiasco," http://www.golfweek.com/pro/pro_other/287239709880948.php.

[11] A significant intangible cost that flows from PING's inability to issue warnings, or fully to discuss *i*FIT Pricing Policy issues with retailers, without incurring unacceptable legal risk includes the deep regret PING's executive management and sales force feel when these important relationships end in such a "legalistic" and abrupt fashion.

PING's strict enforcement of its *i*FIT Pricing Policy has created great consternation among retailers and consumers alike. As one of PING's closed retailers stated:

> Everything in this world is not black & white . . . as your policy would make one believe. We would never do anything intentionally and knowingly to hurt the PING brand. We just promote it, push it, and sell it. Closing our account for such a small misstep is like having your driver's license taken away for life because you got a parking ticket.[12]

Another PING retailer described its termination this way:

> No phone call, no warning, no one even asking me what had happened or our side of the story. I am still shocked that your company would end a 17 year relationship so easily and in such a "flippant" manner.[13]

Yet another retailer bemoaned PING's unwillingness to consider his track record as a PING retailer by noting the following:

> Our staff made a mistake. We readily admit to this. Doesn't loyalty run two-ways? Doesn't a twenty year history of consistent sales, prompt payment, and brand loyalty mean anything?[14]

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[12] Letter from Jim Plowman of the Club House in Thousand Oaks, California, to John Solheim of PING, dated February 13, 2006.

[13] Letter from Rick Danruther of Sierra Lakes Golf Club to John Solheim of PING, dated November 7, 2006.

[14] Letter from Jim Roschek of Milham Park Golf Club to Bill Gates of PING, dated February 1, 2006.

Consumers, likewise, have been irritated and confused by the actions PING has taken to comply with *Dr. Miles* and *Colgate*. One consumer voiced his deep frustration in a recent internet discussion forum:

> So on the basis of a single mistake on a single product, they pull the account without warning? For good or just temporarily? Wouldn't the professional business like approach of been to warn the account holder and give them a timeframe to correct it?[15]

If the Court adopts a rule of reason standard for vertical minimum resale price agreements, companies like PING would have the option of entering into pricing agreements with retailers, would be able to discuss these agreements freely with retailers and consumers, and would be able to make reasonable decisions as to the enforcement of such agreements. Consumers would benefit because such pricing agreements would preserve a competitive option for them, PING's custom-fit clubs and customer service, without leading to precipitous closures of their local retail outlets.

* * *

Vertical minimum resale price agreements are a more efficient and procompetitive means of achieving the goals of PING's *i*FIT Pricing Policy – protecting a company's brand and enabling it to compete by offering customized products and service. Under no reasonable economic view of the world do such arrangements fall into that narrow

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[15] *See* http://www.golfwrx.com/forums/index.php?showtopic=62735 (according to an e-mail received from a consumer who posted on this internet discussion forum, more than 3000 individuals have viewed that page and more than 140 posts have been made).

category of "agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958). Companies like PING that adopt resale pricing policies for procompetitive purposes should not be forced to damage their relationships with retailers and consumers, and limit consumer choice, in order to avoid risking *per se* liability. A better alternative, one that is consumer-oriented and market-driven, is to change existing law to apply the rule of reason to vertical minimum resale price agreements to allow companies like PING to enter into pricing agreements with retailers that would involve negotiation and the free flow of communication between a manufacturer and its retailers.

We acknowledge and appreciate the Court's reluctance to overrule existing precedent, but the rule of *stare decisis* should not serve as a roadblock to common sense. *See, e.g., State Oil*, 522 U.S. at 20-21 ("*[s]tare decisis* is not an inexorable command. . . . Accordingly, this Court has reconsidered its decisions concerning the Sherman Act when the theoretical underpinnings of those decisions are called into serious question. . . . ") (quotation and citation omitted). Where, as here, the very purpose of the antitrust laws is thwarted by precedent that is economically obsolete, the Court should not be reluctant to order a change.

CONCLUSION

This Court should reverse the decision of the Court of Appeals, overrule *Dr. Miles*, and hold that vertical minimum resale price maintenance agreements should be evaluated under the rule of reason.

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January 22, 2007

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